

Duke Law Journal

VOLUME 53

MARCH 2004

NUMBER 5

REFORMING FORECLOSURE: THE UNIFORM NONJUDICIAL FORECLOSURE ACT

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ABSTRACT

The Uniform Nonjudicial Foreclosure Act is one of the few creative approaches to mortgage foreclosure to emerge in many decades. In this Article, the authors examine why uniformity in foreclosure law among the states is desirable and, accordingly, advocate foreclosure reform. They analyze the Act, promulgated in 2002, giving specific attention to the Act's new methods of foreclosure by negotiated sale and by appraisal. They also examine the Act's numerous special protections for residential debtors and consider the effectiveness of the Act's procedures concerning subordinate leases, titles arising from foreclosures, surpluses and deficiencies resulting from foreclosures, and fairness of foreclosure prices. They conclude that the Act is fair and well balanced as between creditors and debtors and that it has the potential to make foreclosures more efficient, benefiting all affected parties. Finally, they argue that because a critical mass of state legislatures likely will not adopt the Act, Congress should consider enacting it as a federal statute.

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INTRODUCTION

“Uniform” is hardly a word that one would use to describe the current law of real estate finance. Mortgage law varies enormously from state to state and represents an often perplexing amalgam of English legal history, common law, and legislation. This disparity remains the reality despite numerous attempts during the past century to achieve greater uniformity, and despite the importance of the American mortgage market to the national economy.

In 2002, following four years of drafting, the National Conference of Commissioners on Uniform State Laws (Conference) promulgated the Uniform Nonjudicial Foreclosure Act (UNFA).¹ UNFA reflects the contributions of some of the nation’s leading real estate finance practitioners and scholars.² It is designed to make American foreclosure law uniform by providing for the prompt and efficient nonjudicial liquidation of real estate collateral while affording substantial safeguards for defaulting borrowers. Residential borrowers receive special protection under UNFA.³

UNFA represents a major innovation in the foreclosure process. Not only does it provide for conventional foreclosure by public auction sale,⁴ it also authorizes foreclosure by appraisal,⁵ a procedure under which the secured creditor can appraise the property, take title to it, and credit the borrower and junior lienors with a price acceptable to all parties. Importantly, it endorses foreclosure by negotiated sale, a process designed to emulate the sale of real estate

1. UNIF. NONJUDICIAL FORECLOSURE ACT (UNFA) (2002), *available at* <http://www.law.upenn.edu/bll/ulc/UFBPOSA/2002final.pdf>.

2. The drafting committee consisted of Carl H. Lisman, Chair; John H. Burton; Lani Liu Ewart; Dale G. Higer; Reed L. Martineau; Robert L. McCurley, Jr.; Lisa Kelly Morgan; Willis E. Sullivan (who regrettably died before completion of the Act); and Dale Whitman, Reporter. Ira Waldman served as the American Bar Association Advisor and Grant Nelson as a representative from the American College of Real Estate Lawyers.

3. *See infra* Part III.

4. UNFA art. 2, §§ 201–210.

5. UNFA art. 5, §§ 501–505.

outside the foreclosure setting.⁶ “Such a sale will be consummated in much the same way as other real property sales; the property may be listed with a real estate broker and advertised extensively.”⁷ The negotiated sale, which land finance scholars have long advocated as an alternative to conventional foreclosure, is designed to produce a higher foreclosure price than the usual auction sale—a result that would benefit both the borrower and junior lienholders.

This Article provides a comprehensive examination of UNFA. First, we focus on the absence of uniformity in substantial areas of American real estate finance law.⁸ In so doing, we describe a hodgepodge of divergent state substantive and procedural rules governing real estate mortgages and their foreclosure. We then examine and evaluate foreclosure by auction sale, currently the pervasive method of foreclosure in this country.⁹ Next, we provide an overview of UNFA and its major innovation, foreclosure by negotiated sale.¹⁰ We then comprehensively analyze UNFA’s major provisions and the extent to which they are consistent with or diverge from the dominant themes of current state law.¹¹ We give special emphasis to UNFA’s protection for residential debtors.¹² Finally, the Article endorses UNFA and assesses its likely impact,¹³ concluding that there is only a remote likelihood that it will be adopted by a substantial number of states.¹⁴ Consequently, we advocate the Act’s ultimate adoption by Congress, a position that we defend as consistent with the values of federalism and the Conference.¹⁵

6. UNFA art. 4, §§ 401–405.

7. UNFA prefatory note at 2–3.

8. *See infra* Part I.A.

9. *See infra* Part II.A.

10. *See infra* Part II.B.

11. *See infra* Parts II–V.

12. *See infra* Part III.

13. *See infra* Part VI.

14. *See infra* Part VI.

15. *See infra* Part VI.

I. MORTGAGE FORECLOSURE IN THE UNITED STATES—THE ABSENCE OF UNIFORMITY

A. *State Law Divergence: An Overview*

Mortgage foreclosure law is in a state of pronounced disarray. A sizeable number of states mandate judicial foreclosure, while others authorize a nonjudicial “power of sale” foreclosure proceeding. Additionally, many states impose a variety of postforeclosure restrictions, including statutory redemption and limitations on deficiency judgments,¹⁶ whereas others provide no such protections for debtors.

Judicial action is the sole foreclosure method in about 40 percent of the states.¹⁷ A typical judicial foreclosure entails a lengthy series of steps: the filing of a foreclosure complaint and *lis pendens* notice; the service of process on all parties whose interests may be prejudiced by the proceeding; a hearing before a judge or a master in chancery who reports to the court; the entry of a decree or judgment; the notice of sale; a public foreclosure sale, usually conducted by a sheriff; the postsale adjudication as to the disposition of the foreclosure proceeds; and, if appropriate, the entry of a deficiency judgment.¹⁸ An appeal may follow in some cases. In a contested judicial foreclosure, delay is endemic, resulting in a time-consuming and costly process.¹⁹

The remaining states utilize “power of sale” foreclosure, a nonjudicial process that is substantially less complicated and costly than its judicial counterpart.²⁰ After varying degrees of notice, the

16. If a foreclosure sale yields less than the mortgage debt (plus the costs of sale), a mortgagee traditionally has the right to obtain a “deficiency judgment” for the difference. *See, e.g.*, RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 cmt. a (1997).

17. GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 558 (4th ed. 2001).

18. *Id.* at 559–60.

19. “The delays and inefficiency associated with foreclosure by judicial action are costly. They increase the risks of vandalism, fire, loss, depreciation, damage, and waste. . . . They add to the portfolio of foreclosed properties held by lenders, secondary mortgage market investors, and government insurers and guarantors of mortgages.” UNFA prefatory note at 2.

20. NELSON & WHITMAN, *supra* note 17, at 581–82. According to a recent paper by Karen M. Pence,

Judicial procedures are substantially more time consuming than power-of-sale procedures. Wood (1997) finds that judicial foreclosures, on average, take 148 days longer than nonjudicial foreclosures, while Freddie Mac’s guidelines for mortgage servicers indicate that foreclosures in the most time-consuming state, Maine (a judicial foreclosure state), take almost 300 days longer than in the quickest state, Texas (a power-of-sale state).

mortgaged property is sold at a public sale by a third party, such as a sheriff or a trustee, or by the mortgagee. Because this process does not normally entail a hearing, it frequently is completed in six to eight months or less.

In almost half of the states, the foreclosure sale is not the end of the road for the borrower.²¹ A concept commonly termed “statutory redemption” allows the mortgagor-debtor—and, in many states, junior lienholders—up to a year or longer to regain title after the foreclosure sale by paying the foreclosure purchaser the sale price plus accrued interest and other expenses.²² Statutory redemption may be available after both judicial and power of sale foreclosure, although some states do not authorize it in the power of sale setting.²³ In the vast majority of the states recognizing statutory redemption, the mortgagor will have the right to remain in possession during this postforeclosure period. Proponents praise statutory redemption as “allowing time for the mortgagor to refinance and save his property, permitting additional use of the property by a hard-pressed mortgagor, and probably, most important, encouraging those who do bid at the sale to bid in at a fair price,”²⁴ because a bid below market value is more likely to result in redemption. However, critics argue that statutory redemption is counterproductive. In their view, the fact that the foreclosure purchaser acquires a defeasible title probably suppresses bidding and results in lower sale prices.²⁵

Perhaps more troubling than the variance among state positions on statutory redemption is the states’ varied treatment of borrower personal liability resulting from postforeclosure deficiency judgments. In about half of the states, a mortgage lender may first obtain a judgment for the amount of the mortgage debt and seek to collect it by enforcement against the borrower’s other assets. If the judgment cannot be satisfied in this manner, the lender can foreclose on the

KAREN M. PENCE, FORECLOSING ON OPPORTUNITY: STATE LAWS AND MORTGAGE CREDIT 5 (Fed. Reserve Bd., Finance and Economics Discussion Series No. 2003-16, 2003), available at <http://www.federalreserve.gov/pubs/feds/2003/200316/200316pap.pdf>.

21. See NELSON & WHITMAN, *supra* note 17, at 689 n.2 (identifying twenty-two state statutes giving borrowers postforeclosure sale redemption rights).

22. *Id.* at 689.

23. *Id.* at 689–90.

24. Darryl A. Hart, Comment, *The Statutory Right of Redemption in California*, 52 CAL. L. REV. 846, 848 (1964).

25. NELSON & WHITMAN, *supra* note 17, at 691. For additional discussion of this result, see *infra* Part II.B.1.e.

mortgaged real estate for the balance.²⁶ Alternatively, the lender may choose to foreclose first and sue for a deficiency judgment after the foreclosure sale.²⁷ The amount of this deficiency judgment is traditionally the difference between the foreclosure sale price and the mortgage debt.²⁸

However, several states regulate personal liability and deficiency judgments by statute, adopting a “one-action” or “security-first” rule that requires the lender to use the second of the two options available in common law states. Under this approach the lender must first foreclose and obtain a deficiency judgment only after the foreclosure proceeding.²⁹ A few states go further and simply prohibit any borrower personal liability on purchase money mortgage³⁰ obligations or after foreclosures by power of sale.³¹ Even among states permitting deficiency judgments, some use “fair value” legislation to limit the deficiency to the difference between the mortgage debt and the fair value of the foreclosed real estate rather than the difference between the debt and the foreclosure sale price.³²

In sum, this area of mortgage law is a mosaic of divergence. Although, at one extreme, some states impose virtually no limitation

26. Grant S. Nelson, *Deficiency Judgments After Real Estate Foreclosure in Missouri: Some Modest Proposals*, 47 MO. L. REV. 151, 152 (1982); *see also, e.g.*, *Lakeside Ventures, L.L.C. v. Lakeside Dev. Co.*, 68 P.3d 516, 519 (Colo. Ct. App. 2002) (providing this option, or the option to foreclose, in Colorado); RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.2 cmt. a (1997) (describing the incorporation of this option into the Restatement).

27. Nelson, *supra* note 26, at 152.

28. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 cmt. a; Nelson, *supra* note 26, at 152.

29. *See, e.g.*, CAL. CIV. PROC. CODE § 726 (West Supp. 2004); IDAHO CODE § 6-101 (Michie 2004); MONT. CODE ANN. § 71-1-222 (2003); NEV. REV. STAT. ANN § 40.430 (Michie 2002); UTAH CODE ANN. § 78-37-1 (2002). For additional discussion of the California approach, *see infra* notes 352–64 and accompanying text.

30. GRANT S. NELSON & DALE A. WHITMAN, *LAND TRANSACTIONS AND FINANCE* 633 (4th ed. 2004) (defining a purchase money mortgage as “[a] mortgage taken by a lender, who may be either a vendor or a third party, to finance the mortgagor’s acquisition of the mortgaged real estate”).

31. *See* ARIZ. REV. STAT. ANN. § 33-729(A) (West 2000) (prohibiting deficiency judgments on purchase money mortgages); CAL. CIV. PROC. CODE § 580b (West Supp. 2004) (same); N.C. GEN. STAT. § 45-21.38 (2002) (same); *see also* ALASKA STAT. § 34.20.100 (Michie 2002) (prohibiting deficiency judgments after power of sale foreclosure), ARIZ. REV. STAT. ANN § 33-814(e) (West 2000) (same); CAL. CIV. PROC. CODE § 580d (West Supp. 2004) (same).

32. For a complete listing of such statutes, *see infra* note 365. *See also* NELSON & WHITMAN, *supra* note 17, at 661–62 (discussing fair value legislation). The statutes use a variety of terms to define the “value” of the property for purposes of a deficiency judgment, including “fair value,” “true value,” “true market value,” “reasonable value,” “appraised value,” “actual value,” and “market value.” *Id.* at 660–61 n.6.

on deficiency judgments and personal liability,³³ the polar opposite is represented by California and a few other states where personal recourse against a borrower is usually unavailable.³⁴ Other states fall somewhere in between these doctrinal poles.

B. The Impact of the Secondary Market for Mortgages

Traditionally, this hodgepodge of state mortgage law was only a minor problem because most lenders, institutional or otherwise, continued to own the mortgages that they originated. However, the “unprecedented expansion of the secondary mortgage market” (the purchase of mortgages from their original holders) over the past three decades has substantially strengthened the argument for uniformity in mortgage law.³⁵ A variety of federally sponsored institutions—most importantly Fannie Mae (formerly the Federal National Mortgage Association), Freddie Mac (formerly the Federal Home Loan Mortgage Corporation), and the Government National Mortgage Association (Ginnie Mae)—purchase large blocks of mortgages from local lenders.³⁶ These federally sponsored enterprises (FSEs) finance a portion of their activity by issuing bonds and equity for sale to the investing public. However, for the most part, the mortgages they buy are “securitized”—packaged into mortgage pools to support mortgage-backed securities for sale to institutional and personal investors worldwide. Because the FSEs guarantee the payment of the principal and interest on these securities, they are especially attractive to the investment community. The secondary mortgage market has been a major factor in creating a vibrant national housing economy. It expands the money available for housing purchases, allowing capital to flow indirectly into real estate from investors who would never consider direct mortgage lending. It permits the flow of funds from capital-rich areas of the nation to areas in which a larger amount of real estate investment capital is needed. It gives mortgage borrowers access to money at highly competitive interest rates.³⁷

33. NELSON & WHITMAN, *supra* note 17, at 653–54.

34. *Id.* at 658–67; *see also id.* at 667–88 (describing California’s antideficiency scheme).

35. Grant S. Nelson, *A Commerce Clause for the New Millennium: “Yes” to Broad Congressional Control over Commercial Transactions; “No” to Federal Legislation on Social and Cultural Issues*, 55 ARK. L. REV. 1213, 1245 (2003).

36. JAMES L. BOTHWELL, U.S. GEN. ACCOUNTING OFFICE, HOUSING ENTERPRISES: POTENTIAL IMPACTS OF SEVERING GOVERNMENT SPONSORSHIP 3–4 (1996).

37. *See generally* NELSON & WHITMAN, *supra* note 17, at 864–76 (describing the functioning and impact of the secondary mortgage market).

However, “there can be no doubt that legal differences from state to state act as a serious impediment to the carrying out of these business arrangements.”³⁸ For example, when a default occurs in a pool mortgage, the speed and efficiency with which the mortgaged real estate is liquidated depends on its geographic location. Thus, if the mortgage is on Texas land, where foreclosure is by power of sale and occurs quickly,³⁹ the money will be returned to the pool promptly and inexpensively. On the other hand, if the mortgaged real estate is in Kansas, where foreclosure is by a costly and cumbersome judicial action,⁴⁰ the expense to the pool is increased.

A similar situation exists with respect to deficiency judgments. If relatively affluent Missouri mortgagors see the value of their houses drop substantially, they face the prospect of a deficiency judgment if a foreclosure sale yields less than the mortgage obligation. Their counterparts in California, however, are immune from such deficiency judgments because of California’s antideficiency legislation.⁴¹ These legal disparities may have a significant impact on the loan size of individual pool mortgages and the interest yields that investors are willing to accept when they purchase mortgage-backed securities.⁴²

C. Efforts to Achieve Uniformity

The past eight decades have witnessed at least four major efforts to achieve uniformity in mortgage foreclosure law. First, the Conference promulgated three acts designed to achieve uniformity in mortgage foreclosure, but which proved unsuccessful.⁴³ Second, in 1997 the American Law Institute created the Restatement (Third) of Property: Mortgages, which seeks to unify a wide variety of mortgage law substance and procedure.⁴⁴ Third, Fannie Mae and Freddie Mac, the two largest federally sponsored secondary market institutions, published dozens of note and mortgage forms aimed at creating uniformity through contract law.⁴⁵ Finally, over the past three decades

38. RESTATEMENT (THIRD) OF PROP.: MORTGAGES 3 (1997).

39. See Debra Pogrud Stark, *Foreclosing on the American Dream: An Evaluation of State and Federal Foreclosure Laws*, 51 OKLA. L. REV. 229, 266 (1998) (charting the time required to complete a foreclosure).

40. *Id.* at 260.

41. See *supra* note 29 and accompanying text.

42. See *infra* notes 421–25 and accompanying text.

43. See *infra* Part I.C.1.

44. See *infra* Part I.C.2.

45. See *infra* Part I.C.3.

Congress has legislated on a wide variety of substantive and procedural mortgage law issues.⁴⁶ However, these attempts at uniformity, as we demonstrate in the remainder of this section, have at best been only modestly successful.

1. *The Uniform Laws Approach.* Although there have been several attempts to achieve mortgage law uniformity through state legislative adoption of uniform acts, such attempts have been singularly unsuccessful. In 1927 the Conference promulgated the Uniform Real Estate Mortgage Act; in 1940 the Conference proposed the Model Power of Sale Foreclosure Act.⁴⁷ Not a single state adopted either proposal.⁴⁸ A similar fate befell more recent initiatives by the Conference to achieve uniformity in state real estate security law, such as the 1985 Uniform Land Security Interest Act (ULSIA).⁴⁹ Intended to be the real estate equivalent of Uniform Commercial Code (UCC) Article 9 for personalty, it received a good deal of scholarly attention and praise.⁵⁰ Under ULSIA the preferred

46. See *infra* Part I.C.4.

47. Harold L. Reeve, *The New Proposal for a Uniform Real Estate Mortgage Act*, 5 LAW & CONTEMP. PROBS. 564, 570 (Autumn 1938); Michael H. Schill, *Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets*, 64 S. CAL. L. REV. 1261, 1278 (1991); Jo Anne Bradner, Comment, *The Secondary Mortgage Market and State Regulation of Real Estate Financing*, 36 EMORY L.J. 971, 1001 n.139 (1987). Moreover, the Central Housing Committee, a federally sponsored entity, proposed a revised Uniform Real Estate Mortgage Act in 1937 that was equally unsuccessful. See ROBERT H. SKILTON, GOVERNMENT AND THE MORTGAGE DEBTOR (1929 TO 1939) 203–04 (1944).

48. SKILTON, *supra* note 47, at 204.

49. UNIF. LAND SEC. INTEREST ACT §§ 101–604, 7A U.L.A. 403 (1999). ULSIA was carved out of an earlier effort of the Conference, the Uniform Land Transactions Act (ULTA), adopted by the Conference in 1975. *Id.* prefatory note, 7 U.L.A. 404. As with the preceding model acts, no state adopted ULSIA.

50. See, e.g., Curtis J. Berger, *ULSIA and the Protected Party: Evolution or Revolution?*, 24 CONN. L. REV. 971, 998 (1992) (“A protected party, in the event of default, enjoys several distinct advantages under ULSIA.”); Roger Bernhardt, *ULSIA’s Remedies on Default—Worth the Effort?*, 24 CONN. L. REV. 1001, 1006 (1992) (“Overall . . . ULSIA did not present an easy road map to follow.”); Marc B. Friedman, *Rentals Roulette: The Mortgagee’s Rights to Rent Under Connecticut Law and ULSIA*, 24 CONN. L. REV. 1093, 1094 (1992) (“ULSIA . . . presents a code-oriented approach that would fill many gaps that may exist in a particular state’s common and statutory law.”); Norman Geis, *Escape from the 15th Century: The Uniform Land Security Interest Act*, 30 REAL PROP. PROB. & TR. J. 289, 292 (1995) (“ULSIA . . . holds the promise of accomplishing for the law of real estate mortgage security what the Uniform Commercial Code has already accomplished so well for commercial law.”); Patrick A. Randolph, Jr., *The Future of American Real Estate Law: Uniform Foreclosure Laws and Uniform Land Security Interest Act*, 20 NOVA L. REV. 1109, 1110 (1996) (“The Uniform Land Security Interest Act (ULSIA) is an idea whose time has come.”).

foreclosure method was by power of sale.⁵¹ Only “protected parties” (residential borrowers) were immune from deficiency judgments, and statutory redemption was abolished for all mortgagors, protected or otherwise.⁵² However, ULSIA proved to be a dismal political failure; no state adopted it.

2. *The Restatement Approach.* The American Law Institute’s recent attempt to achieve uniformity in the law of mortgages has been marginally more successful. The Restatement (Third) of Property: Mortgages, promulgated by the Institute in 1997, seeks to “unif[y] the law of real property security by identifying and articulating legal rules that will meet the legitimate needs of the lending industry while at the same time providing reasonable protection for borrowers.”⁵³ Indeed, in the past several years numerous state courts have adopted various provisions of the Restatement.⁵⁴ However, because state court adoption of Restatement provisions is voluntary and depends on litigation, achieving national uniformity via this route is a difficult, painfully slow, piecemeal process. Moreover, even courts that are willing to follow the Restatement can do nothing about existing state

51. See ULSIA prefatory note & § 509, 7A U.L.A. 406, 464–65 (stating that the ULSIA will “facilitate the sale and resale of secured real estate loans”).

52. See *id.* § 113, 7A U.L.A. 425–27 (defining “protected party”); *id.* § 511, 7A U.L.A. 468–69 (prohibiting deficiency judgments against protected parties); *id.* § 513 cmt., 7A U.L.A. 471–72 (no right of statutory redemption).

53. RESTATEMENT (THIRD) OF PROP.: MORTGAGES 3 (1997).

54. See, e.g., *Land Holdings (St. Thomas) Ltd. v. Mega Holdings, Inc.*, No. 1998-078, 1999 WL 1044836 (D.V.I. Nov. 8, 1999), *aff’d*, 283 F.3d 616 (3d Cir. 2002) (adopting Restatement section 8.5—merger); *Krohn v. Sweetheart Props., Ltd.*, 52 P.3d 774, 783 (Ariz. 2002) (en banc) (adopting Restatement section 8.3—adequacy of foreclosure price); *Lamb Excavation v. Chase Manhattan Mortgage Corp.*, 95 P.2d 542, 545–48 (Ariz. Ct. App. 2004) (adopting Restatement section 7.6—subrogation); *New Milford Sav. Bank v. Jajer*, 708 A.2d 1378, 1385 (Conn. 1998) (adopting Restatement section 8.6—marshaling); *E. Boston Sav. Bank v. Ogan*, 701 N.E.2d 331, 334 (Mass. 1998) (adopting Restatement section 7.6(a)—subrogation); *Cadle Co. v. Bourgeois*, 821 A.2d 1001, 1008 (N.H. 2003) (adopting Restatement section 5.1, cmt. 1—land remains encumbered when transferred); *Westmark Commercial Mortgage Fund IV v. Teneform Assocs.*, 827 A.2d 1154, 1160 (N.J. Super. Ct. App. Div. 2003) (adopting Restatement section 6.2, cmt. c—prepayment); *Kim v. Lee*, 31 P.3d 665, 670 (Wash. 2001) (en banc) (adopting Restatement section 7.3—mortgage modification and subrogation). Many other courts have cited provisions of the Restatement favorably without formally adopting them. See, e.g., *Hanley v. Pearson*, 61 P.3d 29 (Ariz. Ct. App. 2003) (citing Restatement section 7.4—surplus); *In re Smink*, 276 B.R. 156, 163–64 (Bankr. N.D. Miss. 2001) (citing Restatement section 2.4—dragnet clauses); *Burney v. McGlaughlin*, 63 S.W.3d 223, 231–32 (Mo. Ct. App. 2001) (citing Restatement section 7.3—mortgage modification); *Bankers Trust Co. v. Collins*, 124 S.W.3d 576, 580 (Tenn. Ct. App. 2003) (citing Restatement section 7.6—subrogation); *Coleman v. Hoffman*, 64 P.3d 65, 68 (Wash. Ct. App. 2003) (citing Restatement section 4.1—duty of care of a mortgagee in possession).

statutes that impose inefficiencies and eccentric rules on the foreclosure process.

3. *Uniformity through Contract.* Both Fannie Mae and Freddie Mac have sought to create mortgage law uniformity through the law of contract. Both entities promulgate mortgage and note forms and mandate their use by lenders who wish to sell their mortgage loans to either of these secondary market enterprises.⁵⁵ Although Fannie Mae and Freddie Mac use distinct forms containing language uniquely applicable to each state, every state's form incorporates twenty-one uniform provisions.⁵⁶ These "Uniform Mortgage and Deed of Trust Covenants" have undeniably created a great deal of nationwide uniformity in a variety of substantive mortgage law contexts.

For example, these forms have been highly effective in promoting the use of nationally consistent language in the casualty insurance context. State default rules governing whether the lender or the mortgagor controls the disposition of insurance proceeds after a casualty loss are in substantial conflict. Absent specific language in the mortgage, many states give the lender the right to prepay the mortgage obligation with insurance proceeds,⁵⁷ whereas other states generally allow the mortgagor to use the proceeds to rebuild unless the lender's security would be impaired.⁵⁸ On the other hand, the

55. An example of such a form can be found in GRANT S. NELSON & DALE A. WHITMAN, *REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT* 1201 (6th ed. 2003).

56. *See id.* at 1204–18 ("The Uniform Covenants (clauses 1 through 21) reproduced below are contained in all Fannie Mae/Freddie Mac single-family mortgages and deeds of trust, and serve to foster national uniformity.").

57. *See, e.g.,* First State Bank v. State Farm Fire & Cas. Co., 840 P.2d 1267, 1269 (Okla. Civ. App. 1992) (holding that insurance proceeds are payable to the lender unless the lender agreed to use the proceeds for repairs); English v. Fischer, 660 S.W.2d 521, 522 (Tex. 1983) (declining to adopt the "novel" concept of good faith and fair dealing to diminish the lender's contractual right to prepay the mortgage obligation); NELSON & WHITMAN, *supra* note 17, at 168–69 (stating that a mortgagor makes a strong argument for restoration of the property because the mortgagee's security will be completely protected).

58. *See, e.g.,* Schoolcraft v. Ross, 146 Cal. Rptr. 57, 58 (Ct. App. 1978) (holding that the insurance proceeds should be used to rebuild because the rebuilding would not impair security, notwithstanding mortgage language giving the mortgagee the option to prepay the mortgage obligation); Starkman v. Sigmond, 446 A.2d 1249, 1250 (N.J. Super. Ct. Ch. Div. 1982) (stating that where the mortgage is silent as to rebuilding, the mortgagor has the right to use insurance proceeds to rebuild unless security would be impaired); RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 4.7(b) (1997) (weighing whether or not courts should permit insurance proceeds to be used for rebuilding); NELSON & WHITMAN, *supra* note 17, at 168–69 (noting that "the mortgagor has a strong argument for application of the insurance proceeds to rebuild to mortgage premises" in the "absence of specific mortgage language governing casualty loss").

Fannie Mae/Freddie Mac uniform covenant language mandates that the insurance proceeds “shall be applied to restoration or repair of the Property, if the restoration or repair is economically feasible and Lender’s security is not lessened.”⁵⁹ Because the use of these forms in residential transactions is pervasive, the foregoing language has become a national norm.

However, there are clear limits to this contract law approach. Uniformity can be achieved only to the extent that state law permits lenders and borrowers to vary state mortgage law by agreement. On matters affecting foreclosure, such as method of sale, deficiency judgments, and statutory redemption, statutes generally govern and state courts are unwilling to permit the parties to use form language to avoid the impact of state law.⁶⁰

4. *Congressional Preemption.* Beginning in the late 1960s, Congress became actively involved in promoting mortgage law uniformity. In 1973 the Nixon administration proposed the adoption of the Federal Mortgage Foreclosure Act as part of the Housing Act of 1973.⁶¹ Under this far-reaching proposal, foreclosure by power of sale would have been mandated for any mortgage made, owned, insured, or guaranteed by any federal instrumentality.⁶² Moreover, the proposal would have invalidated state statutory redemption rights.⁶³ This effort failed to win congressional approval.⁶⁴

During this same period, however, Congress enacted two pieces of federal legislation that focused on specific consumer issues affecting residential borrowers. The first of these statutes, the Truth-

59. *E.g.*, FANNIE MAE/FREDDIE MAC, FORM 3001, ALABAMA—SINGLE FAMILY—FANNIE MAE/FREDDIE MAC UNIFORM INSTRUMENT cl. 5 (instrument rev. Jan. 2001), available at <http://www.efanniemae.com/singlefamily/pdf/3001.pdf>.

60. *See, e.g.*, *DeBerard Props. v. Lim*, 85 Cal. Rptr. 2d 292, 293 (1999) (holding that the statutory protection against deficiency judgments could not be waived by a contract purporting to waive such protection as consideration for new contract terms); *Freedland v. Greco*, 289 P.2d 463, 467–68 (Cal. 1955) (in bank) (holding that a prohibition on purchase money mortgage deficiency judgments could not be contractually waived in advance of or at the time that the obligation was incurred); *Brunson v. Scarlett*, 465 N.W.2d 162, 168–69 (N.D. 1991) (concluding that rights under antideficiency judgment statutes were not subject to contractual waiver before default).

61. *See* S. 2507, 93d Cong. §§ 401–419 (1973), reprinted in ADMINISTRATION'S 1973 HOUSING PROPOSALS, HEARINGS, NINETY-THIRD CONGRESS, FIRST SESSION, ON S. 2490, S. 2507, AND S. 2508, OCTOBER 2, 3, AND 4, 1973, at 394 (1973).

62. *Id.* § 404.

63. *Id.* § 415(d).

64. Schill, *supra* note 47, at 1282.

in-Lending Act of 1968,⁶⁵ mandates that lenders disclose to home borrowers a wide variety of information including the amount of the loan, the finance charges stated in terms of “the annual percentage rate,” the payment schedule, delinquency charges, and prepayment penalties.⁶⁶ The second statute, the Real Estate Settlement and Procedures Act of 1974 (RESPA)⁶⁷ requires lenders in federally related mortgage loans to deliver to mortgagors, prior to settlement, forms detailing all charges that the mortgagor will incur at the settlement or closing of the home loan transaction.⁶⁸ It also regulates the amounts that borrowers are required to pay into mortgage escrow accounts.⁶⁹ Finally, RESPA restricts the payment of fees and “kickbacks” in connection with settlement services.⁷⁰ Neither of these statutes, however, significantly supplants state law.

In the 1980s, Congress went further, adopting three statutes that preempt state mortgage law in a direct and forceful manner. Each statute was the product of the extremely high interest rates and the crisis that afflicted savings and loan associations during the late 1970s and early 1980s. The first, the Depository Institutions Deregulation and Monetary Control Act,⁷¹ made effective in 1980, preempted state usury laws for all federally related loans secured by first liens on residential real estate. This law, which was aimed especially at preempting usury limitations that were enshrined in state constitutions and were thus impervious to legislative change, affected interest rate ceilings and restrictions on discount points and other finance charges.⁷²

Second, Congress enacted the Garn-St. Germain Depository Institutions Act of 1982 (Garn-St. Germain)⁷³ rendering enforceable

65. 15 U.S.C. §§ 1601–1667 (2000).

66. *Id.* § 1638.

67. 12 U.S.C. §§ 2601–2617 (2000).

68. *Id.* §§ 2603–2604. The definition of “federally related” loan, located at section 2602(1), is so broad that it encompasses virtually all home mortgage loan transactions. Schill, *supra* note 47, at 1283.

69. 12 U.S.C. § 2609.

70. *Id.* § 2607(a).

71. 12 U.S.C. § 1735f-7 (2000). Regulations issued under this statute are found in 12 C.F.R. § 590.

72. *See id.* § 1735f-7a (concerning laws limiting mortgage interest, discount points, and finance charges).

73. *Id.* § 1701j-3. *See generally* Grant S. Nelson & Dale A. Whitman, *Congressional Preemption of Mortgage Due-on-Sale Law: An Analysis of the Garn-St. Germain Act*, 35

the due-on-sale clause—a pervasively used mortgage provision enabling a lender to accelerate the debt and foreclose if the real estate is transferred without the lender’s permission. Prior to the enactment of Garn-St. Germain, conflicting state case law and legislation had created enormous turmoil over due-on-sale enforcement.⁷⁴ Congress directly intervened to preempt (with certain minor exceptions) this state law labyrinth.⁷⁵

The Alternative Mortgage Transactions Parity Act of 1982⁷⁶ (AMTPA) was the third prong of this preemptive effort. It authorized state-chartered financial institutions to make mortgage loans using alternative formats (such as adjustable rate, graduated payment, and reverse annuity mortgages) that were approved by federal regulatory agencies for federally chartered lenders, even though such loans would otherwise violate state law.⁷⁷ AMTPA was designed to equalize federal and state institutions’ powers to experiment with new mortgage formats. Ironically, several federal decisions have gone beyond this equalizing principle to hold that *all* aspects of alternative mortgages, including features having nothing to do with their “alternative” character, are preempted from state regulation.⁷⁸

In 1995 Congress considered but, as in 1973, failed to enact a comprehensive statute that would have authorized foreclosure by power of sale for all federally owned, insured, or guaranteed loans.⁷⁹ Nonetheless, the 1980s and 1990s saw the enactment of two less sweeping federal foreclosure statutes. Each provides for nonjudicial foreclosure of residential mortgages held by the Department of Housing and Urban Development (HUD). The Multifamily Mortgage Foreclosure Act of 1981⁸⁰ (Multifamily Act) authorizes

HASTINGS L.J. 241 (1983) (discussing mortgage transfer restrictions before and after Garn-St. Germain).

74. See NELSON & WHITMAN, *supra* note 17, at 326–27, 331–32 (describing judicial approaches to dealing with due-on-sale clauses and state limitations on due-on-sale clauses).

75. *Id.* at 335–56.

76. 12 U.S.C. §§ 3801–3806. The applicable regulations are found in 12 C.F.R. § 560.220.

77. NELSON & WHITMAN, *supra* note 17, at 905–08.

78. See Nat’l Home Equity Mortgage Ass’n v. Face, 239 F.3d 633, 640 (4th Cir. 2001) (holding that a Virginia limitation on the imposition of prepayment penalties was preempted); Shinn v. Encore Mortgage Servs., Inc., 96 F. Supp. 2d 419, 422 (D.N.J. 2000) (holding that AMTPA preempted a New Jersey limitation of prepayment charges). *But see* Glukowsky v. Equity One, Inc., 821 A.2d 485, 492 (N.J. Super. Ct. App. Div. 2003) (holding that a 1996 federal regulation authorizing state-chartered lenders to impose prepayment charges was *ultra vires*).

79. See Patrick A. Randolph, *The New Federal Foreclosure Laws*, 49 OKLA. L. REV. 123, 123–26 (1996) (reciting the scope of the 1995 “Federal Foreclosure Bill”).

80. 12 U.S.C. §§ 3701–3717 (2000).

nonjudicial power of sale foreclosure for federally insured and certain other mortgages on property other than one-to-four-family dwellings held by the secretary of HUD. The Single Family Mortgage Foreclosure Act of 1994⁸¹ (Single Family Act) does the same for HUD-held mortgages on one-to-four-family residences. The two acts are substantially similar, and both preempt state antideficiency and statutory redemption legislation.⁸² Regulations implementing both acts were consolidated into one regulation in 1996.⁸³

A nonjudicial foreclosure procedure employing a power of sale may be utilized under the Multifamily Act and Single Family Act even though the mortgage contains no express power of sale. Following a default and an affirmative decision to foreclose, the HUD secretary designates a commissioner to conduct the foreclosure and sale. Foreclosure is initiated by the service of a notice of default and foreclosure sale containing information concerning the property being foreclosed, the date and place of sale, and related information.⁸⁴ This notice must be published once a week for three consecutive weeks and posted on the property for at least seven days prior to the sale.⁸⁵ In addition, it must be sent by certified mail, return receipt requested, at least twenty-one days before the date of the foreclosure sale; delivery must be made to the original mortgagor, to those liable on the mortgage debt, to the “owner” of the property and, at least ten days before the sale, to all persons having liens thereon.⁸⁶ Neither the acts nor the regulations require mailed notice to lessees, holders of easements, and others holding interests junior to the mortgage being foreclosed. Although the acts themselves do not mandate a hearing, the regulations require one with respect to multifamily foreclosures: “HUD will provide to the mortgagor [and current owner] an opportunity informally to present reasons why the mortgage should not be foreclosed. Such opportunity may be provided before or after

81. *Id.* §§ 3751–3758.

82. *See* Randolph, *supra* note 79, at 126 (describing the parallels between these two foreclosure laws for HUD loans); Stark, *supra* note 39, at 238–40 (summarizing the two preemptive federal foreclosure laws and Congress’s motivations for creating them).

83. 24 C.F.R. §§ 27.1–27.123 (2004).

84. 12 U.S.C. §§ 3706, 3757; Nonjudicial Foreclosure of Multifamily and Single Family Mortgages, 24 C.F.R. §§ 27.15, 27.103 (2003).

85. 12 U.S.C. §§ 3708, 3758(3).

86. *Id.* §§ 3708(1), 3758(1)–(2).

the designation of the foreclosure commissioner but before service of the notice of default and foreclosure.”⁸⁷

One should not overemphasize these federal efforts to foster uniformity. Mortgage law, and especially the rules governing foreclosure, remains largely the province of the states. Local divergence is still the norm. Moreover, nearly all states are saddled with a method of property disposition that is largely ineffective and wasteful—the auction.

II. THE FORECLOSURE SALE

In the great majority of United States jurisdictions, foreclosure—both judicial and nonjudicial—is conducted by means of a public auction.⁸⁸ The prevalence of auctions in itself raises questions, given that auctions are not a common way of arranging arms-length market sales of real estate in the United States. In this Part we examine the auction’s effectiveness as a mechanism for disposing of foreclosed real estate. In doing so, we consider the economic theory of auctions, the uses of auctions outside the foreclosure context, the particular limitations on the effectiveness of auctions in the foreclosure situation, and the results of two important empirical studies of foreclosure auctions. All of these considerations point to the conclusion that auctions are a relatively inefficient method of property disposition in foreclosure.

We then turn to the methods of property disposition authorized by UNFA, which continues to permit auction foreclosures but introduces two new methods—foreclosure by negotiated sale and foreclosure by appraisal. We consider the ways in which UNFA attempts to improve the effectiveness of foreclosure auctions—attempts that are worthwhile, but with a beneficial impact constrained by the inherent characteristics of auctions and by political factors. More importantly, we consider the advantages as well as the limitations that inhere in UNFA’s two new methods of foreclosure. We conclude that these methods have the potential to revolutionize

87. 24 C.F.R. § 27.5(b). For an analysis of the Multifamily Act and Single Family Act and post-1994 congressional attempts to expand their coverage to other federally held mortgages, see Randolph, *supra* note 79, at 123.

88. The principal exceptions are Connecticut and Vermont, where “strict foreclosure,” in which the mortgagee simply takes title to the security property, is common. NELSON & WHITMAN, *supra* note 17, at 555.

foreclosure, producing higher prices and thus benefiting both lenders and borrowers.

A. *The Status Quo: The Auction Sale and Its Alternatives*

1. *What's Wrong with Auctions?* The traditional foreclosure auction has two functions: first, to evaluate the property for the purpose of determining whether the debtor and subordinate lienholders are entitled to a surplus or whether the debtor owes a deficiency; and second, to liquidate the property by passing title to the highest bidder at the sale.

The sort of auction employed in foreclosure sales in the United States is often termed the “English auction,”⁸⁹ and is characterized by the following features. Bidders physically congregate in a single location. They call their bids orally, so that each bidder is immediately aware of the bids of others. Bids move progressively upward. An individual may bid multiple times, and the sale is awarded to the highest bidder. In an English auction, the selling price is determined by the opinion of value of the second highest bidder—the runner-up. This follows from the fact that the second highest bidder, by definition, has decided not to continue bidding upward, suggesting that the penultimate bid reflects the limit of the runner-up bidder’s opinion of the auction property’s value. The highest bidder need bid only a nominal amount—say, one dollar—above the runner-up’s top bid to take the property, even if the highest bidder’s opinion of the property’s value is much greater than that amount.

Selling real estate by means of an English auction has certain undeniable advantages to both sellers and buyers. From the seller’s viewpoint, auctions are quick, avoiding the delay in receiving the sale proceeds that would result from a lengthy marketing period. This rapidity can drastically reduce carrying costs—property taxes, insurance, security, management expense, and, most significantly, the loss of income from the seller’s capital if the property is vacant or is

89. See Paul R. Milgrom & Robert J. Weber, *A Theory of Auctions and Competitive Bidding*, 50 *ECONOMETRICA* 1089, 1089–90 (1982) (defining the “English auction”). The material describing the economic aspects of auctions in this Article appeared in a somewhat different form in Dale A. Whitman, *Chinese Mortgage Law: An American Perspective*, 15 *COLUM. J. ASIAN L.* 35 (2001).

producing only a below-market income.⁹⁰ Moreover, if there are numerous well-informed bidders, even a seller who is relatively uninformed or ignorant of market conditions can expect to obtain a reasonable price. From the buyer's viewpoint, auctions reduce the period of indeterminacy. Assuming that any reserve price has been met, the seller cannot withdraw or renege on the transaction once the bidding begins, and buyers will learn quickly whether their bids are acceptable.

Despite these advantages, there are numerous reasons that English auctions typically result in below-market prices. An English auction must, by its nature, occur at a given point in time; hence its exposure of the property to the market is inherently limited to the potential buyers who are active on the date of the auction.⁹¹ By contrast, a negotiated sale typically results from the marketing of the property over some period of time—often several weeks or months. Because prospective buyers may enter or leave the market at random intervals, a longer marketing time is likely to result in exposure to more potential buyers, and thus to a higher probable price.⁹² Moreover, in a small market or one that is already glutted by oversupply, an auction in which a large number of properties is offered may itself depress prices as a consequence of the increase in supply resulting from dumping the entire auction inventory on the

90. See Alan R. Kravets, *Going, Going, Gone! Real Estate Auctions in the 90s*, PROB. & PROP., May–June 1993, at 38, 40 (“Auctions produce savings . . . [that] can be dramatic and usually exceed the marketing costs.”).

91. In recent years, there has been some experimentation with auctions of real estate by means of the internet. See Gus G. Sentementes, *Web Auctions Have Homes to Sell: Going, Going: Several Dot-Com Companies See a Future in Selling Real Estate via Bidding Through the Internet*, BALT. SUN, Oct. 22, 2000, at L1 (“Buying items—from collectibles to cars—through an online auction is nothing new to web surfers interested in the thrill of going against other cyber bidders.”); Jackie Spinner, *Uncle Sam Gets Web Auction Bug; GSA Finds Public Ready and Willing to Buy Surplus Real Estate Online*, WASH. POST, June 12, 2001, at E1 (“The government . . . has added a new and potentially huge new market by advertising and even selling [its surplus] property online, borrowing from the popularity of commercial auction sites such as eBay.”). Examples of such on-line auction websites include Bid4Assets, <http://www.bid4assets.com> (last visited May 24, 2004), and Real Auction Referral, <http://www.realauctionreferral.com/reaestate.html> (last visited May 24, 2004). There is some a priori reason to expect that this approach will produce higher prices than in-person auctions, because an on-line auction can be conducted over several days or weeks, rather than occurring on a single day, thus exposing the properties to a larger set of prospective buyers.

92. There is evidence that, even with negotiated sales, longer periods of time on the market are associated with higher prices paid. See John D. Benjamin et al., *What Do We Know About Real Estate Brokerage?*, 20 J. REAL EST. RES. 6, 14–16 (2000) (summarizing the results of studies of the relationship between brokerage participation, time on the market, and price).

market in a single day.⁹³ This effect may occur in locales where all foreclosure sales are customarily (or by law) conducted on the same day of the week or month.

Auctions also carry an undesirably negative connotation about the property being sold. In the United States, auctions have historically been associated in the public mind with distress sales. Most auctions in America result from mortgage foreclosures, judgment sales, property tax sales, bankruptcy sales, and estate sales. Well-publicized auctions have also been held in recent years by the Resolution Trust Corporation, which was responsible for liquidating the assets of insolvent savings and loan associations from 1989 to 1997,⁹⁴ and by HUD, which holds an inventory of foreclosed houses whose owners have defaulted on mortgage loans insured by the Federal Housing Administration.⁹⁵ These, too, are examples of distress sales, and the properties involved were and (in the case of HUD) are often of less than stellar quality.

There are exceptions, of course; auctions have occasionally been used in the United States to market unique, high-value real estate,⁹⁶ or to market large quantities of subdivision houses or condominium

93. See Martin Ginsburg, *The New Wave of Auctioning Will Not Wash in a Soft Market*, REAL EST. FIN. J., Winter 1991, at 72, 73 (“Flooding the market with a large quantity of units when buyers are hesitant must drive down prices.”); see also Christopher J. Mayer, *Assessing the Performance of Real Estate Auctions*, 26 REAL EST. ECON. 41, 55 (1998) (postulating that single-site auctions might draw lower prices than scattered-site auctions because of the concentration of preferences in a single sale site).

94. See FED. DEPOSIT INS. CORP., MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE 1980–94, at 1 (1998) (examining “the challenges faced by the FDIC and the RTC in resolving troubled banks and thrifts during the financial crisis of the 1980s and early 1990s”). For an overview of the events leading to the creation of the RTC, see Jerry W. Markham, *Banking Regulation: Its History and Future*, 4 N.C. BANKING INST. 221, 247 (2000). See generally Edward L. Rubin, *Communing with Disaster: What We Can Learn from the Jusen and the Savings and Loan Crises*, 29 LAW & POL’Y INT’L BUS. 79, 79 (1997) (discussing implications of the savings and loan crisis).

95. See Marcus T. Allen, *Discounts in Real Estate Auction Prices: Evidence from South Florida*, 69 APPRAISAL J. 38, 39 (2001) (“As a result of foreclosures, HUD frequently assumes ownership and possession of properties pledged as collateral for FHA-insured mortgage loans.”); Marcus T. Allen & Judith Swisher, *An Analysis of the Price Formation Process at a HUD Auction*, 20 J. REAL EST. RES. 279, 281 (2000) (drawing the same conclusion).

96. Larry Finley, *Under the Gavel, Real Estate Auctions Play Big Role in Builder Closeouts and Bankruptcies*, CHI. SUN-TIMES, July 28, 2000, at N1 (describing the auction of a 5,000-square-foot home, valued at \$3 million and located on a private island); Jim Szymanski, *Going Once, Going Twice Real Estate: Banking on a New Trend, Edgewood Estate Is on the Auction Block, After Six Months with a Realtor*, TACOMA MORNING NEWS TRIB., Feb. 23, 2001, at D1 (describing the auction of a 17,000-square-foot estate valued at \$2 million).

units in extremely high-demand market conditions.⁹⁷ Nonetheless, auctions generally have the reputation in America for offering properties that are substandard or problematic, and that may not be of interest to a broad segment of the market. This reputation per se may discourage some prospective buyers from participating. It is particularly likely to be a strong factor in the minds of bidders at foreclosure auctions, because it is well recognized that properties being foreclosed may have been poorly maintained by their former owners, vandalized, or gutted.

The standardization⁹⁸ of the auction transaction can also discourage potential buyers. For example, seller financing is difficult to arrange in an auction. There is no opportunity to engage in face-to-face negotiation of the financing or to tailor it to the needs and qualifications of an individual buyer. Hence, unless the seller is willing to negotiate and announce a prearranged financing package, bidders will need to arrange their own financing.⁹⁹

In addition, auctions usually call for the successful bidder to make a substantial deposit¹⁰⁰—as much as 10 to 20 percent of the total

97. See Randy Drummer, *Real Estate & Retail: Internet Auction Set for Kaufman & Broad Homes*, CAL. BUS. PRESS, Oct. 16, 2000, at 10 (relating the sale of sixty-five new houses in southern California by internet auction); see also *Auctions are Growing in Popularity Again, with Benefits for Both Developers and Home Buyers: Property Auctions Back in Vogue*, BANGKOK POST, Apr. 19, 2001 (describing the rising popularity of property auctions in Bangkok); *Ryland Sizzles in Bay Area Home Auctions with \$10.8 Million in Sales*, P.R. NEWSWIRE, Nov. 16, 2000 (describing the successful online auction of fourteen new houses in a highly desirable location in California's Bay Area for an average of \$771,300, nearly \$25,000 more than the average asking price).

98. See Kravets, *supra* note 90, at 41 (“What contingencies can a prospective purchaser put into the sales contract? None. The prospective purchaser does not have the ability to renegotiate the sales contract. This is why the sales agreement drafted by the seller has to be fair and commercially reasonable.”). Of course, in a foreclosure auction—as opposed to a commercially arranged auction—there are no meaningful contract “terms,” and hence much less protection for bidders.

99. Steven L. Good & Sheldon Gottlieb, *Real Estate Auctions: A Guide for the Seller's Lawyer*, PROB. & PROP., Sept.–Oct. 1988, at 41.

100. For example, bidders purchasing at U.S. Treasury sales are usually required to make a deposit of 20 percent of the bid at the time of sale, although some auctions require full payment within one hour of the completion of the sale. See <http://www.treas.gov/auctions/irs/index.html>, (last visited Oct. 5, 2004) (on file with the authors). Private auctioneers commonly require a 10 percent deposit on the day of sale. *E.g.*, HIGGENBOTHAM AUCTIONEERS INT'L, LTD, INC., HOW TO BID, at <http://www.higgenbotham.com/how-bid.asp> (last visited May 24, 2004) (on file with the *Duke Law Journal*); see also A.J. BILLIG & CO., UPCOMING AUCTIONS, at http://www.ajbillig.com/upcoming_auctions.html (last visited May 24, 2004) (on file with the *Duke Law Journal*) (listing upcoming auctions, each of which requires, payable at the time of the auction, a specified deposit of up to 10 percent of the purchase price, payable within twenty-four hours after the auction). Mortgage foreclosure auctions may also require a substantial

price—on the auction date, and to pay the remainder of the price within a short time. The deposit must typically be in “good funds,” and a personal check is unlikely to be acceptable. Thus, the bidders must come to the auction armed with letters of credit, cashiers’ checks, or the like, and must have prearranged financing for the rest of the price. This preparation is a considerable effort for a bidder, an effort that may be hard to justify in light of the fact that no individual bidder has any assurance of prevailing at the auction. Hence, only professionals or dedicated and knowledgeable amateurs are likely to bid.

The standardized, “cookie-cutter” nature of auctions, and particularly foreclosure auctions, argues especially strongly against their use for properties in which individual negotiation is desirable to deal with idiosyncratic problems. For example, if the property is in poor physical condition, has structural problems, or is contaminated by hazardous waste, an auction provides no way for an individual buyer to arrange for inspections or engineering studies, the creation of an escrowed fund to cover the costs of remediation, or other creative solutions.¹⁰¹ In these idiosyncratic situations, one would expect foreclosure auctions to perform even worse than ordinary auctions in terms of price maximization, because bidders must build worst-case estimates of future expenses into their bids.

2. *The Special Problems of Foreclosure Auctions.* If the goal of a sale is to achieve a market price, selling real estate by auction is, as the previous discussion has illustrated, inherently problematic. However, foreclosure auctions, as they operate in the United States, introduce a new and additional set of problems and barriers, making the realization of a market price even less likely. A comparison of

deposit. *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-810(A) (West Supp. 2003) (requiring a deposit of \$1,000); VA. CODE ANN. § 55-59.4(A)(2) (Michie 2003) (requiring a deposit of 10 percent of the amount bid). However, a number of states require full payment of the bid at the conclusion of the sale, a feature that further chills the interest of nonprofessional bidders. *See, e.g.*, CAL. CIV. CODE § 2924h(b) (West Supp. 2004); IDAHO CODE § 45-1506(9) (Michie 2003); UTAH CODE ANN. § 57-1-27(1)(a) (Supp. 2004).

101. Kenneth M. Lusht, *A Comparison of Prices Brought by English Auctions and Private Negotiations*, 24 REAL EST. ECON. 517, 527 (1996); *cf.* Mayer, *supra* note 93, at 53–58 (finding that single-site auctions, typically involving clustered groups of new or relatively new houses, resulted in discounts below expected negotiated sale prices—discounts that were much smaller than those obtained in scattered-site auctions involving older, more heterogeneous groups of houses).

foreclosure auctions with commercial auctions will illustrate these problems.

In a commercial auction, the seller will often prearrange financing and make it available to purchasers. This sort of arrangement is not foolproof; the financing might not be the best available to some bidders, and in all events the successful bidder will need to qualify under the credit standards of the prearranged lender. Even so, prearranged financing clearly can make the auction more attractive for many prospective bidders. Foreclosure auctions do not provide this advantage; bidders must arrange their own financing, which may require a significant investment of time and effort. This investment may be a significant barrier to bidding, given the uncertainty of any individual's becoming the successful buyer.

It is essential that buyers have adequate information about the property being sold if market price is to be achieved. Sellers who use commercial auction sales recognize this fact, and generally provide very extensive disclosures of information, termed "bid packages," to prospective bidders. Such packages may include engineering and architectural reports on the buildings and their systems, detailed plans and surveys, environmental audits, and the like. This information encourages higher bids because it tends to reduce the level of uncertainty that bidders experience.

Foreclosure auctions offer no such advantage. In foreclosure auctions, bidders often know virtually nothing about the property beyond what can be seen from the public streets.¹⁰² Foreclosing lenders may or may not possess additional information about the property—appraisals and environmental audits, for example—but they have no duty to distribute such information to prospective bidders and may well be reluctant to do so because of concern that they will be held liable for errors in the information. This reluctance is understandable, particularly because the foreclosing lender is not the owner and typically has not been in possession of the property. Hence the lender has no simple means of verifying that the information in its files, even if originally accurate, remains accurate at the time of sale.

Commercial auctions are usually accompanied by ample opportunity for prospective bidders to view the property, including

102. Occasionally, prospective bidders may be allowed to inspect a property near prior to foreclosure, but in many cases the mortgagor will still be in possession and will have no interest in facilitating such an inspection process.

the interior of the buildings, and perhaps even to conduct their own technical inspections. Furthermore, in addition to offering information, commercial auction sellers may provide express warranties about the condition of the property. This is particularly true in auctions of new houses or condominium units.

Because arms-length negotiated sales of new residential properties are commonly accompanied by express warranties of quality, commercial auction sellers realize that they too must provide such warranties if they are to realize market prices. Once again, foreclosure auctions provide no similar protections. In a foreclosure auction, the property is always offered "as is, where is," with no liability to the buyer on anyone's part if the property turns out to be defective.

The same is true with respect to the condition of the property's title. In a commercial auction, the "bid package" will routinely include a copy of a title report on the property, showing existing easements, covenants, and other encumbrances. This report will usually serve as an advance commitment from a title insurance agency to provide actual title insurance policies to the successful bidder and any mortgage lender financing the purchase. In many areas of the nation, the seller, again conforming to the practice in negotiated sales, will pay for a title insurance policy for the successful bidder.

No similar advantages are available in foreclosure auctions. Prudent bidders at a foreclosure auction must obtain a title report and title insurance commitment in advance of the sale; otherwise, they may be unaware of encumbrances that could seriously and adversely affect the property's value.¹⁰³ Indeed, it seems that every year a few inexperienced bidders buy real estate at foreclosure sales without realizing that the property is subject to a mortgage or lien senior to the mortgage being foreclosed. From the buyer's viewpoint this situation is an unmitigated disaster, because as a practical matter the property's value is reduced by the sum necessary to discharge the prior lien. This is one reason, among many, that amateurs should and generally do stay away from foreclosure sales, leaving them to experienced professional speculators. As a result, however, the size of the buyer market is limited and prices are to some extent suppressed.

103. See *Carteret Savs. & Loan Ass'n v. Davis*, 521 A.2d 831, 835 (N.J. 1987) ("It is likely that the low turnout of third parties who actually buy property at foreclosure sales reflects a general conclusion that the risks of acquiring an imperfect title are often too high.").

In sum, it would be difficult to design a sale procedure less apt to result in market prices than the usual foreclosure auction. The absence of so many features that buyers in negotiated sales have come to expect virtually ensures that below-market prices will prevail. One might wonder why mortgage lenders have not exercised their political power to improve the process. After all, the lender is better off if the price is higher, at least up to the amount of the mortgage debt. However, lenders long ago stopped viewing foreclosure sales as a way of liquidating the properties on which they hold mortgages. From the lender's viewpoint, the sale's function is, in the great bulk of cases, simply to place the property's title in the lender's hands. Such properties become "real estate owned" ("REO" in industry parlance) to lenders, and they can then concentrate on liquidating the properties by conventional arms-length negotiated sales using such conventional methods as newspaper display advertisements and listings with real estate brokers.

How does the lender get title at a foreclosure sale? In most cases, the lender simply bids the amount of the mortgage debt (including accrued interest, any late fees, and the costs and expenses of the foreclosure process). If no higher bid materializes, the lender will acquire title without expending any new money at all. Such bids, commonly called "full credit bids," are cost-free to lenders; the bid is a "wash," going out of one pocket of the lender and back into another. If a third-party bidder outbids the lender's full credit bid, the lender is generally delighted, for this means that the lender's debt will be paid in full and the lender will be spared the trouble of liquidating the property. However, in most cases there are no third-party bids, and the lender acquires title.¹⁰⁴ Occasionally the lender may believe that the property's value significantly exceeds the debt, so that buying the property for a bit more than the debt seems to present an attractive speculative opportunity. In such cases, the lender may bid more than the full amount of the debt if there is competitive bidding. But most lenders are not speculators, and if they can recover their full

104. See Debra Pogrud Stark, *Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U. MICH. J.L. REFORM 639, 656–57, 663 (1997) (stating that the mortgagee was the successful bidder in 88.8 percent of 1993 judicial sales and 90.4 percent of 1994 judicial sales in Cook County, Illinois); Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as De Facto Strict Foreclosure—An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 CORNELL L. REV. 850, 874–75 (1985) (stating that the mortgagee was the successful bidder in 77 percent of all sales in a sample of 118 foreclosures in Syracuse, New York in 1979).

investment, including interest and costs, they are content to leave the future remarketing of the property to someone else.

Thus, up to the amount of the secured debt, lenders generally do not care whether third parties bid at foreclosure sales. In a large majority of cases, foreclosure does not liquidate the property at all, serving merely to transfer title to the lender as a prelude to subsequent liquidation efforts.¹⁰⁵

It might not be immediately obvious why this process should necessarily disfavor borrowers and subordinate lienholders. It is quite common, of course, for the market value of the security property to exceed the mortgage debt by a significant margin. In theory, a fair liquidation process would bring market value in such cases, allowing the lender to recover its full debt and costs and producing a surplus that could be distributed to any junior lienholders and to the borrower.

In reality, however, the American foreclosure process almost always disadvantages borrowers and subordinate lienholders. To illustrate why, we must temper our definition of "market value." No seller realistically expects to receive in cash the full market price of the property, even if the nominal selling price is the equivalent of market value. The reason for this lies in the fact that every sale involves some selling expenses and some holding period. The selling expenses will commonly include a real estate brokerage commission—typically somewhere between 3 and 6 percent of the sale price, depending on the seller's relationship with the broker—plus the costs of an owner's title insurance policy (in the areas of the nation where sellers customarily pay this expense) and various miscellaneous items, such as transfer taxes and fees of escrow or closing agents. In a negotiated sale the holding period itself introduces additional costs, including property taxes, casualty and liability insurance, inspection costs, perhaps security services, and the opportunity cost that arises from the fact that the capital value of the property is tied up and temporarily unproductive. These costs are particularly significant if the seller has vacated possession of the property in anticipation of the sale, so that the property is generating no offsetting income. Finally, in the case of a sale of foreclosed

105. For this reason, Professor Wechsler described the traditional foreclosure by auction as functioning, in reality, much like strict foreclosure. *See* Wechsler, *supra* note 104, at 885, 862 n.193, 863 nn.194–96.

property, determining market value requires consideration of the lender's costs of conducting the foreclosure and acquiring title.

In determining how much the market price should be reduced to reflect these costs, a useful reference point is the Department of Veterans Affairs (VA), which publishes an annual estimate of the percentage reduction in selling prices that is necessary to reflect net values to sellers. The VA's data are based on its experience with a very large inventory of foreclosed residential properties located throughout the nation. The estimates published by the VA have varied from year to year, but in recent years have generally been in the range of 10 to 14 percent of sale prices; the current figure, in effect since January 2000, is 11.87 percent.¹⁰⁶ Such estimates seem plausible and are confirmed by the work of Professor Debra Stark, whose study of foreclosures in Cook County, Illinois concluded that 14 percent of the resale price was a reasonable estimate of the average of such expenses¹⁰⁷—a figure quite consistent with the estimates of the VA. Professor Stark's estimate was based on an assumed property value of \$75,000, but there is no a priori reason to suppose that the cost of disposing of more valuable commercial or other nonresidential property would vary by significantly different percentages, since most of the elements of disposal cost, such as property taxes, insurance, commissions, and opportunity costs are roughly proportional to the property's value.

If these data are realistic, they suggest that a seller who makes an arms-length negotiated sale of property for \$100,000 might expect to receive a net amount of \$86,000 to \$90,000.¹⁰⁸ If a commercial property sells for \$1 million, the seller might expect a net return of \$860,000 to \$900,000. In a well-functioning foreclosure system—

106. See DEP'T OF VETERANS AFFAIRS, HOME LOAN GUARANTY SERVICES: SERVICERS HOMEPAGE, at <http://www.homeloans.va.gov/servicers.htm> (last modified Feb. 2, 2004) (on file with the *Duke Law Journal*). Prior to the establishment of the current estimate, the estimates by fiscal year were as follows: FY 90: 11.45%, Loan Guaranty: Percentage to Determine Net Value, 55 Fed. Reg. 5112 (Feb. 13, 1990); FY 91: 10.19%, 56 Fed. Reg. 5451 (Feb. 11, 1991); FY 92: 10.94%, 57 Fed. Reg. 10,216 (Mar. 24, 1992); FY 93: 14.16%, 57 Fed. Reg. 58,548 (Dec. 10, 1992); FY 94: 11.19%, 59 Fed. Reg. 24,213 (May 10, 1994); FY 95: 11.18%, 60 Fed. Reg. 5250 (Jan. 26, 1995); FY 96: 15.11%, 61 Fed. Reg. 7046 (Feb. 23, 1996); FY 97: 13.54%, 62 Fed. Reg. 29,393 (May 30, 1997); FY 98: 13.97%, 63 Fed. Reg. 7051 (Feb. 11, 1998).

107. Stark, *supra* note 104, at 676. Professor Stark based her estimate on interviews with lenders and other efforts to estimate carrying and resale expenses sustained by foreclosing mortgagees in reselling their foreclosed properties. See *id.*

108. This assumes, of course, that there are no junior liens to be paid out of the sale proceeds.

which, as this Article has demonstrated, the present system certainly is not—one might, at best, reasonably hope for returns on foreclosed property at a comparable level.

3. *Empirical Evidence on the Fairness of Foreclosure Prices.* If foreclosure sales do indeed produce below-market prices, it should be possible to demonstrate this empirically. However, few investigators have attempted the rather daunting task of examining statistically the actual results of large numbers of foreclosure sales. In this Section we consider the results of two such studies, with specific attention to their conclusions about the adequacy of prices paid. Both studies suggest that, although in the majority of foreclosures the prices paid are reasonably close to market values, in a small but significant minority of foreclosure sales the price bid is well below market value. This discrepancy allows the bidder to capture a windfall financial gain that, in principle, should belong to the debtor or creditor.

The first of these two empirical studies of foreclosure prices was conducted by Professor Steven Wechsler on the basis of 118 foreclosure sales conducted in Onondaga County (Syracuse), New York during 1979.¹⁰⁹ The second study was conducted by Professor Stark on the basis of 870 foreclosures filed in Cook County (Chicago), Illinois in 1993 and 1994, of which about one-third (276) proceeded to an actual foreclosure sale.¹¹⁰

As a rough gauge of the fairness of foreclosure prices, one can compare the amount for which the mortgagee purchased the property at the foreclosure sale with the amount for which it was subsequently resold. If mortgagees are frequently able to liquidate their REO properties at prices higher than acquisition cost, it follows that the acquisition cost was probably below market. Professor Wechsler's data indicate that mortgagees resold REO properties above acquisition cost in about half of the cases, with a median "profit" in these cases of \$5,080.¹¹¹ To give this figure context, the median original loan amount for the entire data set was \$20,400,¹¹² and the

109. Wechsler, *supra* note 104, at 880.

110. Stark, *supra* note 104, at 663.

111. Wechsler, *supra* note 104, at 880. Professor Wechsler commented, "[W]hile on the average mortgagees lose money when they foreclose, many individual transactions result in profitable resales." *Id.* at 853. However, the term "profit" is a dubious descriptor here, since it does not take into account the amount of the mortgage debt or the mortgagee's preforeclosure expenses in connection with the loan. *See supra* notes 106–08 and accompanying text.

112. Wechsler, *supra* note 104, at 872.

median outstanding balance at the time of foreclosure was about \$23,000.¹¹³

Judgments about the fairness of the foreclosure bid from these data require considerable care. Two factors may skew one's inferences. First, there is no assurance that all mortgagees made full credit bids. If there is no third-party bidding, a mortgagee might bid a lower amount, or even a nominal amount such as one dollar. In such cases, the mortgagee's real investment in the property is the balance owing on the loan (including foreclosure costs), even though the bid does not reflect that amount.¹¹⁴

The other factor that must be considered is the mortgagee's foreclosure, holding, and marketing costs. Professor Wechsler's data do not attempt to take account of this factor, which we have estimated above at 10 to 14 percent of the foreclosure bid. Some of the resales that Professor Wechsler describes as profitable may well have constituted losses to the mortgagee if these added costs had been considered. For example, if one takes the median outstanding loan balance of \$23,000 as a proxy for a full credit bid by a mortgagee, median holding and marketing costs can be estimated at \$2,300 to \$3,450 per case. Given the reported nominal median profit for lenders of \$5,080, it is apparent that true profits must have been realized in a substantial number of these cases, but not the roughly 50 percent of cases that Professor Wechsler reports.

Professor Stark's conclusions are quite consistent with Professor Wechsler's, although Professor Stark reports a smaller percentage of cases in which mortgagees were able to resell REO property at a profit.¹¹⁵ She summarizes her findings as follows:

[I]n the vast majority of those cases where the property was sold at foreclosure sale, the lender was the successful bidder and resold the property for a loss, but . . . occasionally, third parties and very few lenders purchased and resold the property for huge profits . . .

113. *Id.* at 874.

114. Professor Wechsler does not attempt to determine whether bids were nominal, full credit, or in between. However, Professor Stark's study indicates that virtually all bids by mortgagees were for the full balance owing on the debt. Stark, *supra* note 104, at 664.

115. After taking holding and marketing costs into account, Professor Stark estimates that mortgagees acquiring property at foreclosure made a true profit in about 20 percent of the cases in 1993 and 10 percent of the cases in 1994. *Id.* at 667–68. The 1994 cases included two spectacular profits, 379 percent and 98 percent. *Id.* at 668.

. . . [T]he foreclosure system typically operates in a manner that protects the borrower's equity in the property. In a very small percentage of the cases, however, the system operates in an unconscionable manner.¹¹⁶

The discussion above has concentrated on resale profits to mortgagees. However, it is fairly obvious that profits upon resale are more likely when third-party bidders purchase at foreclosure sales. As noted in Section A.2, most lenders are not speculators and are averse to the sort of risk inherent in buying property for future profitable resale. For this reason, most lenders are quite willing to make a full credit bid and then allow the property to go to a third-party bidder who offers a higher price. Hence, properties whose value exceeds the mortgage debt by a wide margin are those that third parties are most likely to buy—assuming, of course, that prospective buyers other than the mortgagee are present at foreclosure sales. And it is precisely these cases in which there is the greatest potential for resale profits.

Both Professor Wechsler's and Professor Stark's studies support this conclusion. Professor Stark's data from 1993 include twelve third-party buyers whose resale prices could be tracked. Nine of these (75 percent) resold at a higher price than their acquisition cost at the foreclosure sale, with a median price difference of \$25,971.¹¹⁷ Five of the nine sold at double their acquisition cost or higher. Even after a generous allowance for holding and marketing costs, it is clear that these third-party bidders made substantial profits. Professor Wechsler's findings were similar: Of the fifteen third-party bidder resales that he was able to track, fourteen properties sold at prices exceeding the foreclosure bid, with price differences ranging in twelve cases from \$7,000 to \$23,000.¹¹⁸ The remaining two cases had much more spectacular price gains: \$42,000 and \$54,000.

On the whole, both Professor Stark's and Professor Wechsler's studies suggest, as Professor Stark observes, that most debtors, most of the time, are not treated unfairly in foreclosure. Unless their properties have a value that exceeds the amount of the debt by 10 to 14 percent, they cannot reasonably expect to realize any surplus from even an ideal system of foreclosure (just as they could not expect to put their properties on the market, sell them, and pay off the mortgage debt with the proceeds). When property values are below

116. *Id.* at 668.

117. *Id.* at 667. The median debt balance in Professor Stark's 1993 data was \$62,646. *Id.*

118. Wechsler, *supra* note 104, at 883.

this level, the price bid at the foreclosure sale is a matter of complete indifference to the debtor unless the lender is expected to seek a deficiency judgment—and, in practice, deficiency judgments are rare indeed.¹¹⁹ In such cases, foreclosure by sale is neither better nor worse than strict foreclosure; the debtor will lose the property and have nothing to show for it, irrespective of the method of foreclosure.

On the other hand, there are significant numbers of foreclosures, albeit a minority, in which the property's value exceeds the mortgage debt by a large enough margin that there is a potential for a sale that will produce a cash surplus, even after taking foreclosure, holding, and marketing costs into consideration. In such cases, one might wonder why the debtor did not sell the property privately to realize the surplus value and avoid the stigma of foreclosure. There are manifold plausible explanations: physical or mental illness, difficulty coping with marriage or family problems, or a temporary or seasonal falloff in demand for real estate, perhaps combined with a very quick foreclosure process that gives the debtor little time to expose the property to the market.¹²⁰

It is in these cases that traditional auction foreclosure is most likely to fail to provide adequate protection for mortgage debtors. When this occurs, someone other than the debtor—the foreclosing mortgagee or a third-party bidder—will realize the surplus, unjustly depriving the debtor of wealth. And in at least a few of those cases, the mortgagee, by virtue of below-market bidding at the foreclosure sale, will seek to collect a deficiency judgment, adding the insult of the artificial deficiency claim to the injury of the debtor's loss of equity value. Although loss of significant equity does not occur for a large percentage of debtors, when it does occur the amount of the loss can be very significant. A principal goal of foreclosure reform should be to alleviate these cases.

119. Professor Wechsler's data indicated that about 80 percent of foreclosure sales (94 sales) resulted in a deficiency, but that the mortgagee obtained an actual deficiency judgment in only one case, and that judgment went uncollected. *Id.* at 877. Professor Stark's data indicated that a deficiency resulted from the foreclosure in only about 25 percent of the cases, and of those, the lender sought a deficiency judgment in 28.2 percent of such cases in the 1993 sample and 12.9 percent of such cases in the 1994 sample. Stark, *supra* note 104, at 664. Thus, deficiency judgments were sought following only 3 to 7 percent of the foreclosure sales.

120. See, e.g., MO. ANN. STAT. § 443.310 (West 2000) (requiring a minimum of twenty days from notice of foreclosure to the date of sale); TEX. PROP. CODE ANN. § 51.002(b) (Vernon Supp. 2004) (repealed effective Jan. 1, 2004) (requiring a minimum of twenty-one days from notice of foreclosure to the date of sale).

B. UNFA's Approach to Improving Foreclosure Dispositions

The drafters of UNFA took a twofold approach to the matter of improving dispositions of property in foreclosure. First, they examined the traditional auction foreclosure process to see if it could be modified in ways that would make foreclosure auction outcomes comparable to outcomes of commercial real estate auctions. Second, they developed two distinct nonauction methods of disposing of real estate in foreclosure.

1. *Improving the Auction Sale Process.* Improving foreclosure auctions is a more daunting process than might first appear. It is possible to devise numerous “improvements” that would have the effect of imposing significant additional workload and liability on lenders. Such changes might be better in theory, but would probably engender lender opposition to adoption of the Act. As we have noted in Section A.2, lenders tend to view a foreclosure auction not as a way of disposing of real estate, but merely a way of acquiring title to it, with the expectation that they will spend additional time and effort to liquidate the property. From this viewpoint, proposals for improving auction sales are largely irrelevant unless they will actually result in competitive bidding in a significantly higher proportion of all auctions—a result that most lenders probably would not expect, no matter what the list of “improvements.” The UNFA drafters worked from the fundamental premise that a statute incapable of attracting at least a modest degree of support from the mortgage lending community would be doomed to failure. This premise was supported by the dismal record of the Conference’s prior uniform acts dealing with real estate—a record for which lender opposition was at least partly responsible. Hence, the drafters tended to discount proposals for improvement that they believed would be unacceptable to the lending community.

This background helps to explain why UNFA’s drafters adopted only a fairly modest list of changes in the traditional process of foreclosure by auction. The principal changes are discussed below.

a. Title Information for Bidders. It is an absolute fact that no person can safely buy at a foreclosure sale without first reviewing the state of the property’s title. The buyer must know the priority of the mortgage being foreclosed in order to know whether other liens on

the property will be terminated by the foreclosure.¹²¹ Occasionally an inexperienced foreclosure purchaser learns this lesson the hard way—by assuming that the mortgage is a first lien, bidding accordingly, and then discovering that prior liens remain as encumbrances on the buyer's newly purchased property.¹²²

At the same time, a foreclosing lender also needs to review the state of title to property before instituting foreclosure. This review is necessary to determine whether junior interests exist and to identify who holds them. If the foreclosure is judicial, their holders must be joined in the proceeding or it will not have the effect of cutting off their interests.¹²³ This is also true under many (although not all) nonjudicial foreclosure statutes,¹²⁴ and it is true under UNFA.¹²⁵

121. Prospective bidders must (1) determine the relative priority of the lien being foreclosed as against other liens on the property, and (2) at least in a judicial foreclosure, determine that all junior lienors have been served with process and made parties to the proceeding. *See* NELSON & WHITMAN, *supra* note 17, at 72–80 (discussing the impact of failing to join a junior lienor). In a nonjudicial foreclosure under a power of sale, the latter step may or may not be necessary. *See* *Dover Mobile Estates v. Fiber Form Prods., Inc.*, 270 Cal. Rptr. 183, 186 (Ct. App. 1990) (indicating that junior interests are automatically cut off by a California nonjudicial foreclosure, irrespective of notice to them). Other authorities suggest that a junior interest holder that does not receive a statutorily mandated notice of a nonjudicial foreclosure is not affected by it. *See* WASH. REV. CODE. ANN. § 61.24.040(7) (West 2004) (stating that a subordinate interest holder omitted from notice under power of sale foreclosure is treated as if omitted from judicial foreclosure). In a judicial foreclosure, it is clear that a junior interest will survive the foreclosure if its holder is not made a party to the action. *See* *Diamond Benefits Life Ins. Co. v. Troll*, 77 Cal. Rptr. 2d 581, 584–85 (Ct. App. 1998) (holding that a junior easement holder who is not joined in a judicial foreclosure is not bound by it); *McNeill Family Trust v. Centura Bank*, 60 P.3d 1277, 1287 (Wyo. 2003) (stating that a subordinate lienholder who is not joined in judicial foreclosure is not bound by it). One might expect the express language of the nonjudicial foreclosure statutes to resolve the issue, but in fact they are almost invariably silent on the point.

122. *See, e.g., Mann v. Household Fin. Corp.* III, 35 P.3d 1186, 1189 (Wash. Ct. App. 2001) (dismissing a foreclosure buyer's claim for misrepresentation against the trustee who conducted the sale). The court held that the trustee had no duty to explain to bidders that the foreclosure was of a lien of second priority. *Id.*; *see also Ostayan v. Serrano Reconveyance Co.*, 92 Cal. Rptr. 2d 577, 583–84 (Ct. App. 2000) (stating that neither the creditor nor the trustee was liable for misleading the bidder when they failed to warn him that the deed of trust being foreclosed was subject to a senior lien).

123. NELSON & WHITMAN, *supra* note 17, at 572–80.

124. Perhaps surprisingly, only slightly more than half of the existing nonjudicial foreclosure statutes provide for personal or mailed notice to junior lienholders or interest holders. *See* ALASKA STAT. § 34.20.070(c)(4) (Michie 2002) (interests of record or of which the foreclosing mortgagee has actual notice); ARIZ. REV. STAT. ANN. § 33-809(B)(1) (West Supp. 2003) (interests of record); ARK. CODE ANN. § 18-50-104(b)(3) (Michie 2003) (interests of record or of which the foreclosing mortgagee has actual notice); CAL. CIV. CODE § 2924b(c)(1) (West Supp. 2004) (recorded successors of the mortgagor's estate, holders of subordinate mortgages, and subordinate lessees and contract vendees; apparently no notice is required to holders of subordinate easements or judgment liens); COLO. REV. STAT. § 38-38-101(7)(a) (2003) (all

Under some nonjudicial foreclosure statutes, the entire sale may be held void for failure to provide notice to a junior party.¹²⁶ Hence, it is of critical importance to the foreclosing lender to review the title.

junior interests of record and unrecorded tenants); HAW. REV. STAT. ANN. § 667-22(c)(2) (Michie 2002) (any prior or junior creditors having a recorded lien on the mortgaged property); IDAHO CODE § 45-1506(1)(b)–(c) (Michie 2003) (persons having liens or interests subsequent to the trust deed, when such lien or interest appears of record prior to the recording of the notice of default, or when the trustee or the beneficiary has actual notice); IOWA CODE ANN. § 655A.3(2) (West Supp. 2004) (all junior lienholders of record); MD. CODE ANN., REAL PROP. § 7-105(c)(2) (2003) (the holder of any subordinate mortgage, deed of trust, or other subordinate interest, including a judgment); MASS. ANN. LAWS ch. 244, § 14 (Law. Co-op. 2003) (all persons of record); MONT. CODE ANN. § 71-1-224 (2003) (the occupant of the property, the mortgagor if within the state of Montana, and every person having or claiming an interest of record in the real estate); N.Y. REAL PROP. ACTS. LAW § 1402(1) (McKinney Supp. 2004) (repealed effective July 1, 2005) (any person having a lien of record upon the mortgaged property, or interest in the mortgaged property subordinate to the mortgage of which the mortgagee has actual knowledge or is on constructive notice); N.C. GEN. STAT. § 45-21.16(b)(3) (2003) (record owner of the real estate, not including the holder of a lien or security interest in the real property or a tenant in possession under an unrecorded lease); OKLA. STAT. ANN. tit. 46, § 45 (West 1996) (any person having an interest, claim, or lien of record in the property whose interest, claim, or lien the mortgagee seeks to foreclose); OR. REV. STAT. § 86.740 (2003) (any successor in interest to the grantor whose interest appears of record, or of whose interest the trustee or the beneficiary has actual notice); S.D. CODIFIED LAWS § 21-48-6.1 (Michie Supp. 2003) (any lienholder or encumbrancer whose interest in the property being foreclosed would be affected by the foreclosure); VA. CODE ANN. § 55-59.1 (Michie Supp. 2004) (any subordinate lienholder who holds a note against the property secured by a deed of trust); WASH. REV. CODE ANN. § 61.24.040 (West 2004) (any person who has a lien or claim of lien against the property recorded subsequent to the recordation of the deed of trust being foreclosed); W. VA. CODE ANN. § 38-1-4 (Michie 1997) (any subordinate lienholder who has previously notified the primary lienholder by certified mail of the existence of a subordinate lien).

Note that nearly all of the provisions cited above contain time limits—for example, that the notice need be given only to persons whose interests are of record at least thirty days prior to the foreclosure sale date or prior to the date of sending notice. This limit is necessary to eliminate an obligation on the part of the foreclosing lender to conduct repeated title examinations down to the actual date of foreclosure. We have eliminated the time provisions from the above list in the interest of brevity and simplicity.

Jurisdictions whose power of sale foreclosure statutes do not require personal or mailed notice to subordinate interest holders include Alabama, the District of Columbia, Georgia, Maine, Michigan, Minnesota, Mississippi, Missouri, Nevada, New Hampshire, Rhode Island, Tennessee, Texas, Utah, and Wyoming. In addition, the requirements of North Carolina and West Virginia are quite weak; North Carolina's notice requirement applies to subsequent parties acquiring title but not to subsequent lienholders, and West Virginia's applies only to subsequent lienholders who have given the foreclosing lender actual notice of their liens. *See infra* note 270.

125. *See* UNFA art. 2, § 203(c) (requiring that notice of the foreclosure be given to any person shown by the public records to be an interest holder in the real property collateral and to any person the foreclosing creditor knows is an interest holder).

126. *Williams v. Kimes*, 996 S.W.2d 43, 46 (Mo. 1999) (en banc) (holding that failure to notify the holder of a contingent remainder rendered a nonjudicial foreclosure void); *Title Ins. & Trust Co. v. Chi. Title Ins. Co.*, 634 P.2d 1216, 1218 (Nev. 1981) (holding that the vendor's

Typically the foreclosing creditor does its own title work, as does each individual bidder. UNFA's drafters viewed this duplication as wasteful. Moreover, the expense of paying for the cost of title evidence (often in the form of a "foreclosure report" from a title company at a cost of at least \$50 to \$100) is surely likely to discourage some bidders because, for every individual except the successful bidder, the cost is a deadweight loss.

To avoid the duplication of expense, UNFA requires the foreclosing creditor to obtain title evidence and provide a copy to each prospective bidder upon request.¹²⁷ The title evidence may be any of the usual forms of title insurance products,¹²⁸ an attorney's opinion based on an examination of title, or any alternative form of title evidence that is customary in the locality. Unless it is an attorney's opinion,¹²⁹ the title evidence "must state that the issuer is willing to provide a policy of title insurance to a person that acquires title to the real property by virtue of the foreclosure and the exceptions and exclusions from coverage to which the policy issued to that person will be subject."¹³⁰ In most cases, then, the title evidence will be a title insurance binder; its purposes are to inform prospective bidders of the existence of any interests that will survive foreclosure, and to assure them that they will be able to insure the title if they buy the property. This provision eliminates the need for each bidder to obtain an individual title insurance commitment, and does so with only trivial additional expense to the foreclosing creditor.¹³¹

failure to notify the vendee of property under the recorded contract of sale rendered the nonjudicial foreclosure void).

127. UNFA art. 3, § 302(a). The statute requires that a copy of the title evidence be provided without cost to "any person" requesting it, but there is no plausible reason that anyone other than a prospective bidder or purchaser would wish to receive it. The advertisement of a foreclosure by auction must state that the title evidence is available and must indicate whom to contact to obtain it. *Id.* § 303(c)(7). Further, at the commencement of the auction, the person conducting it must make copies of the title evidence available to prospective purchasers who have not already obtained it. *Id.* § 308(a)(1)(A).

128. *See* UNFA art. 1, § 102(22) ("Title evidence' may be denominated in a variety of ways, depending on local custom or practice.").

129. The exclusion for attorneys' opinions of title resulted from the drafting committee's discomfort with the notion that an attorney could be required by law to provide an opinion of title to a client whom the lawyer did not specifically agree to represent. Additionally, requiring attorneys to provide title opinions to successful bidders might give rise to conflicts of interest in some cases.

130. UNFA art. 3, § 302(a).

131. *Id.*

b. Other Information for Bidders. Foreclosing creditors often possess a great deal of information about the properties on which they foreclose. Their files may contain appraisals, environmental assessments, surveys, engineering studies, inspection reports, and a variety of other documents. The UNFA drafting committee considered whether to require foreclosing creditors to disclose such information. However, such a requirement would pose several difficulties. Beyond the title evidence, there is no standard set of documents that lenders would always or routinely possess. The drafting committee did not want to require the creation of documents that were not already in existence, as such a requirement would undoubtedly have added significantly to lenders' costs and administrative burdens and would likely have stimulated serious opposition to UNFA. Hence, any requirement that documents be disclosed would inevitably have a "hit-or-miss" effect, producing many documents in some cases and few or none in other cases.

Moreover, lenders may have good reasons not to disclose some documents. A report might contain proprietary information that the lender wishes to protect. It might reflect badly on the lender's care or wisdom in making the original loan, or on the way the loan has been serviced over its life. It might even cast doubt on the lender's compliance with applicable supervisory regulations. Perhaps worst from a lender's viewpoint, a document might cast a pall on the property's desirability—perhaps erroneously—and might therefore chill not only the bidding at the foreclosure sale, but also the lender's subsequent efforts to market the property.

For these reasons, the drafting committee concluded that it was impractical to require any specific disclosures except for title information. Instead, the committee simply authorized foreclosing creditors to make other reports or information available to prospective bidders. To encourage such disclosures, UNFA exculpates creditors from liability for errors in such information unless the foreclosing creditor has actual knowledge of the error when the information is disclosed.¹³² This step admittedly falls far short of making foreclosure auctions comparable to commercial real estate auctions, in which detailed informational packages are routinely distributed, but the drafting committee could find no acceptable way of expanding the disclosure requirement.

132. *Id.* § 302(b)–(c).

c. Inspecting the Collateral. A major limitation of foreclosure auctions is the difficulty that prospective bidders experience in inspecting the property before the sale. The need for inspection is, if anything, greater with foreclosure auctions than with commercial auctions of real estate, because it is well known that defaulting debtors often feel little incentive to provide good maintenance on properties that they expect to lose in the immediate future. “Stripping” or even vandalism of properties to be foreclosed is common. Hence, prospective bidders have a strong need to inspect. Because they are usually unable to do so, they are likely to formulate their bids based on worst-case assumptions.

Unfortunately, the need to inspect conflicts headlong with the notion, held in so-called “lien theory” states, that the property belongs to the debtor until the foreclosure is completed, and that it is an infringement of the debtor’s rights to encroach on possession before foreclosure.¹³³ Of course, a statute could modify or even reverse that concept, but the UNFA drafting committee was concerned that attempting to break down the mortgagor’s preforeclosure right of possession would produce strong opposition from consumer interests. Some members of the committee had serious concerns as to whether such a change would be fair to borrowers.

Even in lien theory states, foreclosing lenders may have the right to take possession of the real estate before foreclosure in limited situations,¹³⁴ such as when the mortgagor has voluntarily relinquished possession or has abandoned the property. In title theory and intermediate theory states, which take the view that the mortgagee is entitled to take possession as soon as a default has occurred, the mortgagee is not so constrained. However, mortgagees are often understandably reluctant to assume possession even under these circumstances, because taking possession actuates a long and frightening list of potential liabilities for mortgagees.¹³⁵ To avoid these

133. NELSON & WHITMAN, *supra* note 17, at 10, 187. The lien theory is followed in more than half of the American jurisdictions. *Id.* at 10.

134. *See, e.g.*, RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 4.1(c) (1997).

135. Those liabilities include strict accounting for all rents and other revenues collected, with duties to the mortgagor that are tantamount to fiduciary duties, *see* Johns v. Moore, 336 P.2d 579, 581 (Cal. Ct. App. 1959); a duty to manage the property in a reasonable, prudent, and careful manner, prevent damage to it, and keep it productive, *see* ComFed Sav. Bank v. Newtown Commons Plaza Ass’n, 719 F. Supp. 367, 375 (E.D. Pa. 1989); liability in tort to third parties injured on the premises, *see* City of Newark v. Sue Corp., 304 A.2d 567, 569 (N.J. Super.

liabilities, mortgagees who want to intercept rents from commercial properties secured by defaulted mortgages often employ equitable receiverships instead of taking direct possession,¹³⁶ but unfortunately a receivership provides no means of giving prospective bidders access to the property.

A lender need not take the full step to formal “possession” to exhibit the property; it is very likely that a debtor could voluntarily authorize a foreclosing creditor to show the property to prospective bidders without making the creditor a “mortgagee in possession” with its attendant liabilities.¹³⁷ Concern by mortgagees that simply showing the property will activate that status is almost certainly exaggerated.¹³⁸ However, it is probably not common for a defaulting mortgage debtor to voluntarily permit the foreclosing mortgagee to show it to prospective bidders.¹³⁹

UNFA does not require the foreclosing lender to become a “mortgagee in possession,” even if the lender could legally do so. The drafters did not feel it would be appropriate to force lenders into such a high-risk situation. However, if a foreclosing lender has already become a “mortgagee in possession,” or if the mortgagor has voluntarily granted the lender the right to show the property to

Ct. App. Div. 1973); liability under statutes imposing duties on owners, *see* *Craig v. Mohyde*, No. CV 940316056S, 1997 WL 206630 (Conn. Super. Ct. Apr. 18, 1997) (recognizing a duty to residential tenants to make repairs under a residential landlord-tenant statute, but finding no duty in the absence of evidence that the mortgagee had taken control of the premises); liability for all goods and services furnished by third parties to the property, *see* *Essex Cleaning Contractors, Inc. v. Amato*, 317 A.2d 411, 412 (N.J. Super. Ct. App. Div. 1974); and liability for breach of any covenants running with the land, *see* *United States Fidelity & Guar. Co. v. Orchard Plaza Ltd. P'ship*, 672 N.E.2d 876, 884 (Ill. App. Ct. 1996). *See also* NELSON & WHITMAN, *supra* note 17, at 195–99 (describing a mortgagee's liability to third parties and duty to account).

136. *See* NELSON & WHITMAN, *supra* note 17, at 207 (stating that a receivership will insulate the mortgagee from the normally imposed tort and landowner liabilities).

137. In retrospect, it might have been wise to include in UNFA a specific provision disclaiming mortgagee-in-possession status to allow mortgagees to show the property to prospective bidders. The Act contains no such provision.

138. *See, e.g.*, *Blackstone Valley Nat'l Bank v. Hanson*, 445 N.E.2d 1093, 1093–94 (Mass. App. Ct. 1983) (holding that a mortgagee who visited the property a few times, asked a tenant to “take care of it,” and made some emergency repairs had not assumed the status of “mortgagee in possession”). *A fortiori*, a mortgagee who merely inspects or invites bidders to inspect the property should not be deemed in possession.

139. In Connecticut it is customary for the debtor to permit inspection, but there is no legal recourse if the debtor refuses to do so. *See* *Second Nat'l Bank of New Haven v. Burtchell*, 349 A.2d 831, 833 (Conn. 1974) (holding that a foreclosure committee had no authority to allow prospective purchasers to inspect a property prior to foreclosure against the mortgagor's wishes); DENIS R. CARON, *CONNECTICUT FORECLOSURES* § 6.01G (1997).

bidders, UNFA requires the lender to reasonably accommodate a request by a prospective bidder to inspect the property.¹⁴⁰

A further provision of UNFA makes a grant of access by the mortgagor somewhat more probable. The Act permits a residential debtor to avoid liability for a deficiency judgment by acting in “good faith” with respect to the property,¹⁴¹ and it contains a safe harbor provision defining “good faith” to include providing “reasonable access to the collateral for inspection by the foreclosing creditor and prospective purchasers.”¹⁴² Residential debtors are informed of this provision in the notice of foreclosure,¹⁴³ and may well see it as in their best interest to cooperate in showing the property prior to foreclosure. Overall, lenders will probably be able to offer inspection to prospective bidders under UNFA more frequently than under present foreclosure procedures, but UNFA by no means makes this a certainty.

d. Advertisement of the Sale. Commercial real estate auctions are usually preceded by a marketing period during which sellers attempt to attract the interest of potential buyers. The marketing devices may include display advertisements in newspapers and magazines and the use of billboards, broadcast media, and the internet. Advertisement of foreclosure auctions, by contrast, is usually conducted only by means of statutorily mandated fine-print advertisements in the classified sections of newspapers. They serve the purpose of alerting professional real estate speculators to sales but are not well designed to attract members of the buying public.

There was a general feeling among the drafters of UNFA that more could be done to expand bidding audiences at foreclosure sales. However, it is not easy to prescribe a marketing program by law, because effective marketing of real estate must, by its nature, be attuned to unique local conditions and customs. Moreover, the drafting committee was reluctant to impose marketing requirements that might substantially increase the cost of foreclosure.

Thus the changes UNFA makes in the advertisement of foreclosure sales are quite modest. UNFA gives the adopting legislature the choice of retaining its existing rules concerning

140. UNFA art. 3, § 304.

141. UNFA art. 6, § 607(b)(2).

142. *Id.* § 607(c)(5).

143. UNFA art. 2, § 204(b)(9).

newspaper advertisement or adopting a simple provision requiring one advertisement per week for three consecutive weeks, with the last publication date between seven and thirty days before the auction. The option of keeping the existing rules was included on the ground that, although some states have rather elaborate, burdensome, and costly advertising requirements,¹⁴⁴ existing newspapers might have a strong stake in retaining those requirements and might vigorously oppose passage of UNFA if it threatened traditional practices.

The other UNFA innovations concerning advertisements are minor. The Act provides that advertisements “may contain any other information concerning the collateral or the foreclosure that the foreclosing creditor elects to include.”¹⁴⁵ The foreclosing creditor may also post a copy of the advertisement or a sign containing information about the auction on the real property collateral.¹⁴⁶

One member of the UNFA drafting committee strongly argued that state governments should create internet sites on which all foreclosures statewide would be listed. The committee as a whole was sympathetic to this idea but reluctant to require its adoption, feeling that it might impose unacceptable costs that could form the basis for opposition to the Act. In the final statute, the concept is reflected in a comment stating that the foreclosing creditor may post information about the sale on an internet site that provides information about foreclosures, whether the site is operated by a private party or by an entity of state or local government.¹⁴⁷

e. Eliminating Statutory Redemption. One additional feature of foreclosure auctions that sharply distinguishes them from commercial real estate auctions in roughly half of the American jurisdictions is the *statutory* postsale right of redemption. This right, which we considered briefly in Part I.A,¹⁴⁸ should not be confused with the equitable right of redemption that is cut off by foreclosure in every state. Statutory redemption arises only after the foreclosure sale and lasts for some statutorily specified period, commonly in the range of

144. For example, the Missouri statute requires that, in cities of at least 50,000 population, the advertisement appear for twenty days, “continu[ing] to the day of sale.” MO. ANN. STAT. § 443.320 (West 2000). For a property with a lengthy legal description, such an advertisement may cost several thousand dollars.

145. UNFA art. 3, § 303(d).

146. *Id.* § 303(b).

147. *Id.* § 303 cmt.

148. *See supra* notes 21–25 and accompanying text.

six months to two years.¹⁴⁹ In effect, it is a right of the former debtor, and in some jurisdictions, any cut-off junior lienholders as well, to repurchase the property from the successful bidder at the foreclosure sale.¹⁵⁰ Although the right is probably not often exercised, it is impossible for bidders to be sure that it will not be asserted. Hence, until the redemption period has expired, successful bidders do not know whether they will be able to retain the property. It therefore makes little sense for successful bidders to invest time, effort, or money on repairs or improvements until the redemption time has elapsed. Thus, the property is likely to remain largely or wholly unproductive to the successful bidder during that period. There is little doubt that statutory redemption rights cast a pall on foreclosure sales in the states in which they apply. Further, in many of the states authorizing statutory redemption, the foreclosure bidder's situation is worse because the former mortgagor has the right to remain in possession during the redemption period.¹⁵¹

Statutory redemption was invented as a supposed prodebtor device, allowing the former owner one last chance to save the property and increasing sale prices by encouraging bidders to bid amounts closer to full market value so that the redemption right is less likely to be exercised.¹⁵² However, its likely effect on debtors as a class is decidedly negative, as foreclosure bidders discount their bids to reflect the uncertainty that they can keep the purchased properties.¹⁵³ For the drafters of UNFA, this problem was easily

149. NELSON & WHITMAN, *supra* note 17, at 689.

150. *Id.* at 694.

151. *See, e.g.*, Fed. Land Bank of Spokane v. Snider, 808 P.2d 475, 480 (Mont. 1991) (holding that the debtor was entitled to possession of the property during the redemption period); CIT Group/Equip. Fin., Inc. v. Travelers Ins. Co., 504 N.W.2d 565, 568 (N.D. 1993) (“[A] mortgagor is entitled to possession of, and to the rents and profits derived from, mortgaged real property from the time of the foreclosure sale until title is divested by expiration of the period of redemption.”).

152. *See* Edgar Noble Durfee & Delmar W. Doddridge, *Redemption From Foreclosure Sale—The Uniform Mortgage Act*, 23 MICH. L. REV. 825, 839 (1925) (“It is clear . . . that redemption statutes have [the] purpose and effect . . . of the prevention of the hardship of a sacrifice sale.”); Hart, *supra* note 24, at 848 (“Purposes include . . . encouraging those who do bid at the sale to bid in at a fair price.”).

153. United States v. Stadium Apartments, Inc., 425 F.2d 358, 365–66 (9th Cir. 1970):

[I]t is argued that the purpose of the redemption statutes is to force the mortgagee and others to bid the full market price at the sale. We assume that this is the purpose; we are not convinced that the statutes accomplish it. What third party would bid and pay the full market value, knowing that he cannot have the property to do with as he wishes until a set period has gone by, and that at the end of the period he may not get

solved. The Act simply provides that persons who have redemption rights “may not redeem after the time of foreclosure.”¹⁵⁴ Hence, a foreclosure auction conducted under the Act will have the same degree of finality as a commercial auction. Under UNFA’s philosophy, whatever the fair period during which to allow mortgagors to redeem their properties, this period ought to run before the date of foreclosure, not after.

2. *Alternatives to Auctions: Foreclosure by Negotiated Sale and by Appraisal.* As the foregoing discussion illustrates, it is not easy to make a foreclosure auction emulate an arms-length sale. Perhaps the most significant innovation of UNFA is its adoption of two new methods of foreclosure—negotiated sale and appraisal—that do not involve auctioning the property at all. These methods have no equivalent in current American foreclosure practice.¹⁵⁵

a. *Negotiated Sale.* Under a foreclosure by negotiated sale, the foreclosing creditor can use any means of attracting a buyer and entering into a contract of sale. For example, the property could be listed with a real estate broker and advertised in magazines and newspapers or on the internet. The contract of sale must be conditioned on the failure of the mortgage debtor to redeem the property by the time of foreclosure.¹⁵⁶ The lender, having arranged for such a sale, then notifies the borrower of its terms, and states the amount the lender is willing to credit against the debt.¹⁵⁷ This amount need not be identical to the contract price that the lender has arranged with the third-party buyer, but must be at least 85 percent of

it, but instead may be forced to accept a payment which may or may not fully reimburse him for his outlays?

154. UNFA art. 2, § 209.

155. They are quite similar to mortgage foreclosure in the United Kingdom. Under an English “power of sale,” the lender is permitted to foreclose simply by selling the real estate to any buyer other than itself or its agents. *See* Law of Property Act, 15 Geo. 5, Ch. 20 §§ 101–107 (1925) (Eng.); BERNARD RUDDEN & HYWEL MOSELEY, AN OUTLINE OF THE LAW OF MORTGAGES 52–57 (3d ed. 1967). The price must be reasonable, although it need not be the highest price obtainable. Lenders in England commonly use real estate brokers (“estate agents”) and other means of conducting foreclosure sales, just as with other sales of real property. Foreclosures by judicial auction are also permissible, RUDDEN & MOSELEY, *supra*, at 67, but are rare in practice. One of the authors of this Article has earlier advocated the adoption of foreclosure by negotiated sale. *See* Nelson, *supra* note 26, at 163–66.

156. UNFA art. 4, § 404(a)(2).

157. *Id.* § 403(a).

that price.¹⁵⁸ The 15 percent difference is intended to allow the creditor compensation for brokerage, marketing, and holding expenses. The lender must disclose the actual contract price to the borrower, thus giving the borrower a reference point in determining whether to accept the lender's offer.

A borrower, once notified of the proposed sale, has the right to accept or reject it.¹⁵⁹ If the borrower takes no action, the sale can be completed by the foreclosing creditor and title will pass to the contract purchaser, subject to any prior liens.¹⁶⁰ The borrower may object to the sale by written notice up to seven days before the proposed sale date. Upon objection from the borrower, the proposed sale is cancelled, and the lender must resort to a different method of foreclosure (or an alternative negotiated sale, presumably with a higher credit offer to the borrower).

The lender must also give notice of the proposed sale to the holders of subordinate liens¹⁶¹ that will be terminated by the foreclosure. They, too, have the right to object up to seven days before the proposed sale. This provision is essential to fundamental fairness; in many cases it will be the junior lienholders rather than the borrower who will suffer practical harm if the foreclosure amount is inadequate, because the foreclosure amount will often be far less than would be necessary to generate a surplus for the borrower. However, the foreclosing creditor may elect not to cancel the sale in the face of objections from junior lienors. Instead, the foreclosing creditor can simply pay off their liens (a course of action likely only if the balances owing on such liens are small) or can notify them that their liens will be preserved rather than terminated by the foreclosure.¹⁶²

158. *Id.* § 403(c).

159. *Id.* § 404.

160. *Id.* art. 6, § 603(1). Title also passes subject to interests whose holders were entitled to notice of foreclosure but to whom such notice was not given, and to interests that, by virtue of a notice from the foreclosing creditor, were expressly preserved from the terminating effect of the foreclosure. *Id.* § 603(2)–(3).

161. Note that nonlien subordinate interest holders, such as tenants or easement holders, are not given notice or the right to object. This is consistent with UNFA's philosophy of making no provision for payment of surplus sale proceeds to such parties. *See infra* notes 324–332 and accompanying text.

162. UNFA art. 4, § 404(a)(2), (3). If the creditor pays off a subordinate lien, the amount of the payment is open to negotiation. Hence, if it appears that a particular objecting lienholder is unlikely to receive much or any of the foreclosure proceeds, it may be possible for the foreclosing creditor to negotiate a payoff at a price well below the lien's face amount.

The concept of the negotiated sale is designed to allow lenders to complete the process of property disposition in a single step, rather than the two-step procedure usually employed now.¹⁶³ From the lender's viewpoint, the negotiated sale should be faster and more efficient. It should be attractive to borrowers as well, because the foreclosure amount realized should ordinarily be a good deal higher than would be experienced in a foreclosure auction. Hence, borrowers can expect to receive a distribution of surplus, or at least a retirement of junior liens on the property, in a higher proportion of cases. From the viewpoint of the borrower and junior lienors, the question is simple: Am I likely to be better off with the sum that the lender has offered as a foreclosure amount than I am with the probable result of an auction? In a large proportion of cases the answer will be affirmative, but if borrowers or junior lienors believe otherwise, they can simply give notice to stop the negotiated sale.

This is not to assert that foreclosures by negotiated sale will necessarily produce prices precisely equivalent to those obtained through arms-length negotiated sales. Such foreclosures will be subject to the uncertainty that results from the right of objection by the borrower and junior lienors until seven days before the proposed sale date, and that very uncertainty will likely result in some discounting of offering prices by prospective buyers. Of course, most real estate sales are subject to some period of uncertainty, because sale contracts commonly allow buyers a due diligence period in which to investigate the property and permit buyers to withdraw from their obligations to purchase if the results of their investigations are unsatisfactory. However, a period of uncertainty that lasts until seven days before the proposed settlement date is much longer than would usually occur in an arms-length negotiated sale. In addition, the borrower and junior lienors can redeem any time before the foreclosure date, and a redemption will result in cancellation of the sale that the lender has negotiated.¹⁶⁴ This extends the uncertainty even further.

The period of uncertainty can be reduced by agreement. A foreclosing lender might contact a borrower (and junior lienors, if any), for example, two months before the proposed foreclosure date, advise them that the lender has arranged a sale of the property, and state the amount that the lender proposes to credit against the debt. If

163. *See supra* Part II.A.2.

164. UNFA art. 2, § 209.

the borrower and junior lienors find the amount fair and attractive, they can simply agree to the sale at that point, thus waiving the right to object for the remainder of the foreclosure period. It makes little difference whether this agreement takes the form of an immediate deed in lieu of foreclosure, a contract to give a deed in lieu of foreclosure at a future date,¹⁶⁵ or simply a waiver of the right to object to the foreclosure amount and to exercise the equitable right of redemption from the mortgage.¹⁶⁶ Whatever the form, the result will be to pin down the lender's right to consummate the sale, eliminating the uncertainty. In theory, an actual foreclosure provides a result superior to a deed in lieu of foreclosure because it cuts off junior liens, which a deed in lieu cannot do. But if the junior lienholders agree to the negotiated sale, they can also provide lien releases in return for distributions of their shares of the sale proceeds. In this setting, foreclosures and deeds in lieu of foreclosure are indistinguishable.

Negotiated sales, like foreclosure auctions, need not be accompanied by any warranty as to the physical quality of the land or improvements (although there is nothing to prevent the foreclosing lender from providing such a warranty), and they will not necessarily carry a warranty of title (although the practical demands of the market may well cause lenders to provide title insurance coverage to their purchasers). Only after the Act is adopted and its operation is observed will it become apparent whether lenders find the speed and efficiency of the negotiated sale process attractive enough to spend the necessary money on the sorts of warranties that the market expects. The 85 percent requirement mentioned above should give them the latitude to do so. Once lenders learn to use the flexible procedures of the negotiated sale foreclosure to meet the market's demands, lenders will be able to get a jump start of up to several

165. This sort of contract does not lend itself to the objection that it is an unenforceable "clog" on the equity of redemption. A contract to give a deed in lieu of foreclosure may well be a "clog" if it is conditioned on occurrence of a future default. See NELSON & WHITMAN, *supra* note 17, at 43-46 (discussing the problems with hinging an agreement on a future forfeiture); John C. Murray, *Clogging Revisited*, 33 REAL PROP. PROB. & TR. J. 279, 287-96 (1998) (giving an overview of the clogging doctrine as applied to deeds in lieu of foreclosure). But in the present context, the default has already occurred and the clogging doctrine is inapplicable.

166. Section 104 of UNFA prevents the parties from varying the effect of the Act by agreement, with certain exceptions. However, this provision should not stand in the way of the sort of agreement described in the text, because its real effect would be to take the transaction outside of the Act, making it the equivalent of a deed in lieu of foreclosure.

months on property disposition, a feature that they should find very attractive.¹⁶⁷

b. Appraisal. The second new method of foreclosure authorized by UNFA, termed “foreclosure by appraisal,” permits the lender to obtain and give to the debtor an appraisal of the property, accompanied by an offer of a proposed net amount that the lender agrees to allow in return for taking title to the property.¹⁶⁸ This method is somewhat like common law strict foreclosure, in the sense that the lender winds up owning the real estate.¹⁶⁹ Unlike a foreclosure by negotiated sale, foreclosure by appraisal does not attempt to accomplish the ultimate disposition of the property in a single step; the lender will take title immediately, and may then engage in marketing the property at whatever pace it desires. This could be an attractive approach if the property is not ripe for immediate marketing—if, for example, it is in poor physical condition or requires remediation of hazardous waste—or if the lender is simply unable to locate an interested buyer quickly enough to consummate a negotiated sale.

c. Common Features of Negotiated Sale and Appraisal. Under UNFA, the protections for borrowers and junior lienholders are precisely the same in foreclosure by appraisal and foreclosure by negotiated sale; in either case, the debtor and junior lienors have the right to object to the proposed foreclosure amount. The appraised value of the property, which must be disclosed to the borrower and junior lienors along with the lender’s proposed foreclosure amount,

167. The Act requires that at least ninety days elapse between the issuance of a notice of foreclosure by the creditor and the actual date of foreclosure. UNFA art. 2, § 207. The foreclosing creditor may begin seeking a purchaser under the negotiated sale process as soon as the notice of foreclosure is issued.

168. This approach is similar to a system advocated by Professor Wechsler. *See* Wechsler, *supra* note 104, at 893 & nn.237–41 (describing the possibility of structuring foreclosure sales like ordinary real estate sales).

169. *See* NELSON & WHITMAN, *supra* note 17, at 554 (describing the vesting of title in the mortgagee after a strict foreclosure). Strict foreclosure—by which title passes directly to the foreclosing mortgagee, rendering an auction unnecessary—was the ordinary method of foreclosure during the period of development of the mortgage in England but today is generally used in the United States only in Connecticut and Vermont. *See, e.g.,* Dieffenbach v. Attorney Gen. of Vt., 604 F.2d 187, 195–96 (2d Cir. 1979) (upholding the constitutionality of Vermont’s strict foreclosure procedure); *Fidelity Trust Co. v. Irick*, 525 A.2d 551, 552–53 (Conn. Ct. App. 1987) (holding that the trial court had discretion to order either strict foreclosure or foreclosure by sale, and did not abuse that discretion by ordering strict foreclosure).

provides a reference point for their decision as to whether to object to the foreclosure. Once again, the functioning of the Act depends on the exercise of intelligent self-interest by borrowers and junior lienholders. If the amount that the lender is offering them is more than they believe they would be likely to receive in a foreclosure auction, they will accept it.

In both foreclosure by negotiated sale and foreclosure by appraisal, the foreclosure amount proposed by the mortgagee becomes binding and conclusive if not objected to, so long as it meets the 85 percent criterion.¹⁷⁰ Neither the borrower nor junior interest holders may otherwise maintain that the foreclosure amount was inadequate.¹⁷¹ This eliminates a major source of risk to lenders that exists with conventional auction foreclosures—that a foreclosure will be set aside because the sale was commercially unreasonable or brought an inadequate price.¹⁷²

If a foreclosing creditor receives a timely objection to a proposed foreclosure by negotiated sale or appraisal, the creditor has a number of options. The creditor might enter into negotiations with the objector, offering to increase the foreclosure amount in return for the objector's revocation of the notice of objection.¹⁷³ If such negotiations are unsuccessful, the creditor must discontinue the foreclosure¹⁷⁴ but can immediately issue a new notice of foreclosure, using either the same method or a different method of foreclosure.¹⁷⁵ It is probable that lenders in this situation would resort to foreclosure by auction,

170. Specifically, the criterion is 85 percent of the selling price in the case of a foreclosure by negotiated sale, *see* UNFA art. 4, § 403(c), and 85 percent of the appraised value in the case of a foreclosure by appraisal, *see* UNFA art. 5, § 503(c).

171. UNFA art. 4, § 404(d); UNFA art. 5, § 504(d).

172. *See, e.g.,* Krohn v. Sweetheart Props., 52 P.3d 774, 776 (Ariz. 2002) (en banc) (setting aside a foreclosure sale when the bid was \$10,304 and the property's value was at least \$57,000, even though there was no other defect in the sale). *But see* McNeill Family Trust v. Centura Bank, 60 P.3d 1277, 1284 (Wyo. 2003) (refusing to set aside a sale on account of inadequate price). *See generally* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.3 (1997) (stating that a grossly inadequate foreclosure sale price will render a foreclosure defective).

173. Revocation of any notice issued under the Act is permissible unless the recipient of the notice has materially changed its position in reliance on the notice. UNFA art. 1, § 111.

174. This is the case unless the objector is a lienholder and the foreclosing creditor is willing to buy out the lien or preserve it from termination by the foreclosure. UNFA art. 4, § 404(a)(2)–(3); UNFA art. 5, § 504(a)(2)–(3).

175. UNFA art. 6, § 601(b)(1)–(3). The creditor can also abandon the foreclosure altogether or commence a judicial foreclosure proceeding, but these courses of action are expected to be relatively rare. *Id.* § 601(b)(4)–(5).

because that is the one form of foreclosure under UNFA that is not subject to any further objection by the borrower or junior lienors.

If the creditor does issue a new notice of foreclosure, another ninety days must elapse before the auction foreclosure sale can be held. However, a lender can eliminate this waiting period by giving an initial notice of foreclosure that specifies more than one method.¹⁷⁶ For example, the lender might issue an initial notice of foreclosure stating that the lender reserves the right to use both foreclosure by negotiated sale and foreclosure by auction. If the lender then proposes a negotiated sale, receives an objection from the borrower, and is unable to negotiate a revocation of the notice of objection, the lender can simply carry out the foreclosure by auction.¹⁷⁷ It seems likely that most lenders would generally specify more than one method in their notices of foreclosure, thus giving themselves greater flexibility.

C. Summary

In sum, foreclosure by negotiated sale or by appraisal offers significant advantages to creditors over the conventional auction sale. A foreclosure by negotiated sale collapses the two-step process—the creditor’s acquisition of title and subsequent disposition of the property—into a single step. This may save considerable time, and it eliminates any need for creditors to concern themselves about payment of insurance, property taxes, or property security expenses while they hold title. A foreclosure by appraisal does not collapse the two steps into one, but it does permit a quick acquisition by the creditor. Both new forms of foreclosure expressly eliminate any possibility of collateral attack on the foreclosure by the debtor on the basis that the foreclosure price was inadequate. This restriction on debtors is fair, because in all cases of foreclosure by negotiated sale or by appraisal, the debtor has in fact agreed to the price offered by the creditor, and therefore should not be heard to dispute its sufficiency later. At the same time, the 85 percent “floor” on the price (computed as a percentage of the contract price or the appraisal, whichever is applicable) provides the debtor a reasonable degree of protection against an unfairly low offer by the creditor.

176. UNFA art. 2, § 204(b)(8).

177. However, the creditor must have advertised the auction as required by section 303 of UNFA.

III. PROTECTING RESIDENTIAL DEBTORS

One of UNFA's key features is that it represents a complete and rather creative rethinking of the special protections provided to residential debtors under existing foreclosure statutes. It is widely believed that residential mortgage debtors need legal protections against the demands of their creditors that are unnecessary for commercial debtors. This belief manifests itself in many existing statutes dealing with mortgage lending. For example, a number of states restrict the imposition of late fees¹⁷⁸ and prepayment charges¹⁷⁹ on residential borrowers. Other states provide residential debtors a statutory right to cure a default without acceleration for some period of time.¹⁸⁰ The Federal Garn-St. Germain Act, which generally approves enforcement of due-on-sale clauses, denies enforcement in the case of certain transactions involving one-to-four-family dwellings.¹⁸¹

It is not entirely clear that there is a sound basis for this distinction between residential and commercial debtors. Perhaps it is assumed that residential borrowers are less sophisticated than commercial borrowers and thus have less capacity to understand loan documents and recognize unfair or undesirable terms. Another possible assumption is that residential borrowers do not usually have, and should not be expected to undertake the expense of acquiring, legal counsel. Hence, general statutes should prevent certain types of overreaching by lenders. We suspect that these generalizations are weak; there are many "mom-and-pop" businesses whose owners have no greater understanding of mortgage loan documents and no greater ability to obtain legal counsel than the typical residential borrower. But the political appeal of providing extra protections to residential

178. See, e.g., CAL. CIV. CODE § 2954.4 (West Supp. 2004); MASS. GEN. LAWS ANN. ch. 183, § 59 (Law. Co-op. Supp. 2004); N.Y. REAL PROP. LAW § 254-b (McKinney 1989); NELSON & WHITMAN, *supra* note 17, at 510–13 (discussing the legislative and other regulatory impacts of late payment charges and default interest).

179. See, e.g., MISS. CODE ANN. § 75-17-31 (2000); MO. ANN. STAT. § 408.036 (West 2001); WIS. STAT. ANN. § 138.052 (West Supp. 2003); NELSON & WHITMAN, *supra* note 17, at 473–82 (discussing legislative and other nonjudicial regulation of prepayment clauses).

180. See, e.g., 41 PA. CONS. STAT. ANN. § 404 (West 1999); see also NELSON & WHITMAN, *supra* note 17, at 546 (describing "arrearages" legislation, which allows the mortgagor to avoid acceleration by curing the preexisting default).

181. Garn-St. Germain Depository Institutions Act of 1982, 12 U.S.C. § 1701j-3(d) (2000); see also *supra* note 73 and accompanying text.

borrowers cannot be denied. There are a large number of residential borrowers, and they vote.

UNFA contains a number of special protections for residential borrowers, many of which were included with an eye toward “enactability.” In essence, these provisions make the Act more politically attractive. This is not to say that the special protections lack a sensible policy basis. On the contrary, perfectly plausible arguments can explain most of them.

The most general of UNFA’s distinctions between residential and nonresidential borrowers is its approval of agreements between creditors and debtors determining “the standards by which performance of an obligation under this [Act] is to be measured if those standards are not manifestly unreasonable.”¹⁸² Such agreements are not permitted for residential debtors.¹⁸³ This provision is maddeningly vague, in contrast to most provisions of UNFA, which are so specific as to leave little room for negotiation or agreement about standards of performance. It is therefore doubtful that this UNFA provision has much practical application.¹⁸⁴

The remaining residential debtor distinctions found in UNFA are identified and analyzed below, except that those relating to debtors’ liability for deficiencies are examined in Part V.

A. *Defining “Residential Debtor”*

UNFA approaches the task of defining “residential debtor” by first defining “residential real property,” and then defining “residential debtors” as those associated with such property. Residential real property is

182. UNFA art. 1, § 104(d).

183. *Id.* § 104(d)(1). Similar language appears in the UCC. *See, e.g.*, U.C.C. § 1-102(3) (2001) (allowing parties to vary their agreements so long as performance is measured by standards that are not manifestly unreasonable); *id.* § 4-103(a) (allowing parties to determine by agreement the standards by which a bank’s responsibility will be measured, if the standards are not manifestly unreasonable); *id.* § 9-603(a) (allowing parties to determine the standards by which the fulfillment of rights and duties are measured, if they are not manifestly unreasonable).

184. Under section 209 of UNFA, a foreclosing creditor is required to cooperate with a person who “attempts to redeem the collateral from the security interest before the time of foreclosure by promptly providing information concerning the amount due or performance required to redeem.” Conceivably, a provision of the security agreement could set out standards as to the extent of the creditor’s duty to provide information.

property that, when a security instrument is entered into with respect to the property, is used or is intended by its owner to be used primarily for the personal, family, or household purposes of its owner and is improved, or is intended by its owner to be improved, by one to [four] dwelling units.¹⁸⁵

Several elements of this definition are worth noting. The phrase “when a security instrument is entered into with respect to the property” was included because the use of property can change over time. The quoted phrase, in effect, locks in the property’s status when the mortgage loan is made; a lender who is not dealing with “residential real property” at that time need not be concerned that a subsequent change in status will trigger obligations that the lender did not anticipate. Hence, the lender will have no need to monitor the status of the property continually over the life of the loan.

The phrase “or is intended by its owner to be used” is designed primarily to deal with the case in which a borrower buys raw land with the expectation of building a residence on it. Of course, if the lender has no reason to know of the borrower’s intention when the loan is made, a court should not find the property to constitute “residential real property” even when it is later converted to residential use.

Several elements of the definition remain. The phrase “personal, family, or household purposes” has become a common legal euphemism for consumer or personal use. It appears in the UCC,¹⁸⁶ the Federal Electronic Fund Transfer Act,¹⁸⁷ the Uniform Consumer Credit Code,¹⁸⁸ the Uniform Consumer Leases Act,¹⁸⁹ the Federal Trade Commission’s Holder in Due Course regulation,¹⁹⁰ and many other legislative enactments. The phrase “of its owner” clarifies that property held exclusively for rental use will not qualify; in essence, the property must be partly owner-occupied. On the other hand, there is no requirement that it be the owner’s principal residence. A second home or vacation home will qualify.

185. UNFA art. 1, § 102(17).

186. *See, e.g.*, U.C.C. § 1-201(b)(11) (defining “consumer”). The definition appears in many other places in the UCC.

187. *See* 15 U.S.C. § 1693a(2) (2000) (defining “account”).

188. *See* UNIF. CONSUMER CREDIT CODE § 3-104(a)(ii) (1974) (defining “consumer loan”).

189. *See* UNIF. CONSUMER LEASES ACT § 102(a)(2)(B) (2001) (defining “consumer lease”).

190. *See* Preservation of Consumers’ Claims and Defenses, 16 C.F.R. § 433.1 (2003) (defining “consumer”).

The final element in the definition of residential real property is the maximum number of dwelling units that the property may contain. UNFA sets the limit at four units, following the usual pattern of federal statutes and regulations, but the number is bracketed in recognition of the fact that in some areas a different number of dwelling units¹⁹¹ may be the customary dividing line between incidental rental use and a commercial rental operation. There is no land area limitation, and in theory a hobby farm containing hundreds of acres would qualify. However, a commercial farm would not, because it would not be used “*primarily* for personal, family, or household purposes.”¹⁹²

Having defined “residential real property,” UNFA then defines a “residential debtor” as an individual “who owns, or is obligated on an obligation secured in whole or in part by, residential real property.”¹⁹³ The reason for the separate mention of “owns” and “obligated on an obligation secured by” is to grant the “residential debtor” protections to guarantors and to individuals who have sold real estate with the purchaser’s assuming or taking subject to a preexisting mortgage.

B. Meeting to Object to Foreclosure

Of the ten or so residential debtor distinctions in UNFA, two stand out as most significant. The first is the exemption from deficiency liability for residential debtors who have acted in good faith. That provision is discussed elsewhere in this Article in the context of deficiency liability generally.¹⁹⁴ The other, which we believe is unique in American foreclosure law, is the “meeting to object to foreclosure,” a right available only to residential debtors.

The drafters had two underlying rationales for the “meeting-to-object” concept. The first was the conviction that some unwarranted foreclosures of residential mortgage loans occur simply because consumers are unable to establish a clear line of communication with their lenders. Large numbers of residential loans are sold on the secondary mortgage market and serviced remotely (that is, from an

191. See, e.g., N.Y. REAL PROP. ACTS. LAW § 1402.1 (McKinney Supp. 2004) (repealed effective July 1, 2005) (setting six units as the threshold for exclusion from nonjudicial foreclosure statute); N.Y. TAX LAW § 253-b (McKinney 1998) (defining a credit line mortgage in terms of property containing one to six units).

192. UNFA art. 1, § 102 cmt. 17.

193. *Id.* § 101(16).

194. See *infra* Part V.B.1.

office located at a different place than the loan originated).¹⁹⁵ The borrower will be given a (usually) toll-free telephone number to call with questions about the loan's servicing, but often that number will simply connect the borrower to a computerized "tree" of automated responses. It can be maddeningly difficult to locate and talk with a person who has authority to take any action with respect to the loan.¹⁹⁶ Even if the borrower believes that the loan is not delinquent, or that for other reasons the lender is not entitled to foreclose, communicating this belief to someone on the lender's staff who can take action may be extremely frustrating.

A second factor motivating the drafters was a desire to create a foreclosure procedure that would withstand an attack on due process grounds. Because of the familiar state action requirement, due process must be observed only if a governmental entity is foreclosing.¹⁹⁷ It involves two elements: notice (about which we have

195. BOTHWELL, *supra* note 36, at 3–4; Keith Turbett, *Community Development Loans and the Secondary Market*, BRIDGES, Spring 1998, available at <http://www.stlouisfed.frb.org/publications/br/1998/a/br1998a3.html>. When a loan is sold, it may be with "servicing retained" (in which case the originating lender will continue to service the loan) or "servicing released" (in which case the investor who purchases the loan will either take over the servicing, or will sell the right to service the loan to some other servicer). In either of the latter situations the new servicer is likely to be located at a distance from the property and borrower. *Id.* On servicing generally, see FANNIE MAE, SERVICE LOANS FOR FANNIE MAE: AN OVERVIEW, at http://www.efanniemae.com/learning_center/servicing_loans/servicing_loans.html (last visited May 24, 2004) (on file with the *Duke Law Journal*). On the valuation of servicing as an asset, see Advisory Letter, Office of the Comptroller of the Currency et al., Interagency Advisory on Mortgage Banking (Feb. 25, 2003), available at <http://www.fdic.gov/news/news/press/2003/PR1403a.html>.

196. See Jack Guttentag, *A Cure for the Mortgage-Servicing Blues*, BANKRATE.COM, Jan. 2, 2003, at <http://www.bankrate.com/brm/news/mortgages/20030102a.asp?> (on file with the *Duke Law Journal*) (discussing the multitude of problems inherent in interacting with mortgage servicing agencies); Michael D. Larson, *Refinancing: New Rate, New Rules*, BANKRATE.COM, Jan. 8, 2003, at <http://www.bankrate.com/brm/news/loan/20010106a.asp?> (on file with the *Duke Law Journal*) (noting the difficulties faced by borrowers in mortgage refinancing and encouraging mortgagees to investigate potential lenders).

197. See NELSON & WHITMAN, *supra* note 17, at 621–25 (discussing the constitutional requirement of a hearing); Grant S. Nelson, *Constitutional Problems with Power of Sale Real Estate Foreclosure: A Judicial Dilemma*, 43 MO. L. REV. 25, 35–45 (1978) (stating that sufficient state action must be connected to a power of sale foreclosure to trigger Fourteenth Amendment requirements); Daniel E. Blegen, Note, *The Constitutionality of Power of Sale Foreclosures by Federal Government Entities*, 62 MO. L. REV. 425, 433–34 (1997) (asserting that direct government instrumentalities implicate the Due Process Clause when using a power of sale clause). Some courts have taken the view that federally owned instrumentalities that are not direct government agencies are not subject to the Due Process Clause in foreclosing, a conclusion that we consider highly doubtful. See, e.g., *Warren v. Gov't Nat'l Mortgage Ass'n*, 611 F.2d 1229, 1235 (8th Cir. 1980) (holding that the Government National Mortgage Association, although wholly owned by the United States and a constituent part of HUD, is not

much to say below)¹⁹⁸ and a right to a hearing.¹⁹⁹ We believe that government agencies can readily adapt UNFA's meeting-to-object process to satisfy the hearing requirement. Under the applicable case law, an agency can appoint an agency employee to conduct the hearing,²⁰⁰ provided that the employee is sufficiently neutral to be an "impartial arbiter."²⁰¹ Selecting a suitable employee will obviously require some thought and care but seems entirely feasible. That employee can then conduct the meeting to object required by UNFA, thereby satisfying the demands of due process as the drafters intended.

The meeting to object²⁰² bears many of the earmarks of a formal hearing. It must be held by the foreclosing creditor (if an individual) or a "responsible representative" of the creditor. The term "responsible" is intended to indicate that the person holding the

subject to the Due Process Clause); *AgriBank FCB v. Cross Timbers Ranch, Inc.*, 919 S.W.2d 263, 268 (Mo. Ct. App. 1996) (stating that the Farm Credit Bank chartered by the United States pursuant to a congressional act is not subject to the Due Process Clause). Occasionally a court has used even more specious reasoning to avoid the application of the Due Process Clause to admitted government agencies. *See, e.g., Fed. Deposit Ins. Corp. v. Morrison*, 747 F.2d 610, 615 (11th Cir. 1984) ("[T]he FDIC has nowhere infringed upon Morrison's property. Foreclosure within the contractual terms and the requirements of Alabama law did not deprive him of his equity of redemption, but only terminated it."). When a foreclosure is conducted by a private lender pursuant to a state nonjudicial foreclosure statute, the case for state action, and hence for application of the Due Process Clause, becomes a great deal weaker. *See Kenly v. Miracle Props.*, 412 F. Supp. 1072, 1075 (D. Ariz. 1976) (finding that a statute setting out qualifications for trustees under deeds of trust, and providing for minimal involvement of a clerk of court, does not rise to the level of state action); *NELSON & WHITMAN, supra* note 17, at 628-34 (discussing sufficient state action).

198. *See infra* notes 217-61 and accompanying text.

199. *See Ricker v. United States*, 417 F. Supp. 133, 138 (D. Me. 1976) ("[T]he Constitution requires a meaningful and timely opportunity to be heard."); *Turner v. Blackburn*, 389 F. Supp. 1250, 1259 (W.D.N.C. 1975) ("[A]t a minimum due process requires the trustee to make an initial showing before the clerk or similar neutral official that the mortgagor is in default under the obligation; the mortgagor must of course be afforded the opportunity to rebut and defend the charges.").

200. *See United States v. Ford*, 551 F. Supp. 1101, 1105 (N.D. Miss. 1982) (stating that the opportunity for meeting with the County Supervisor of the Farmers Home Administration combined with a failure to respond to mail notices was sufficient to satisfy the hearing requirement). The court found no relevance in the fact that a "meeting" rather than a "hearing" was offered to the debtors. *Id.* at 1106 n.2 ("[W]e consider this to be an insignificant question of semantics . . .").

201. *See, e.g., Johnson v. United States Dep't of Agric.*, 734 F.2d 774, 782-83 (11th Cir. 1984) (expressing doubt that the use of a district director from a nearby district of the Farmers Home Administration would be sufficiently neutral because "[t]he nearby district director will be evaluating a decision to foreclose made by a peer and already approved by his boss, the state director.").

202. UNFA art. 2, § 206.

meeting has authority to decide whether the foreclosure will proceed. Neutrality is not required and, except when government agencies seek to satisfy due process, the person conducting the meeting may well be a loan officer, other employee, or attorney of the lender with direct responsibility for servicing or foreclosing the loan. On the other hand, there is nothing in the Act to preclude the use of a neutral person who has no other duties in connection with the mortgage loan. Within ten days after the meeting, the arbiter must render a decision on whether to proceed with the foreclosure, issuing “a written statement indicating whether the foreclosure will be discontinued or will proceed and the reasons for the determination.”²⁰³ Thus, the decision must take a form much like the traditional “findings of fact and conclusions of law” employed in judicial hearings.²⁰⁴

The meeting is similar to a judicial hearing in other ways. Both parties may be represented by counsel, and the debtor may bring an advisor who is not a lawyer. The person conducting the meeting (or some other representative of the lender who is present) must possess and make available to the debtor “[d]ocuments that provide evidence of the grounds for foreclosure.”²⁰⁵ Ordinarily these documents will take the form of loan payment records, or, if the default is based on some conduct of the debtor other than a payment default, a record of that conduct.²⁰⁶ In effect, the lender has the initial burden of producing evidence that foreclosure is warranted. The debtor receives an opportunity to present objections to the foreclosure, and the person conducting the meeting must “consider” them.²⁰⁷ These objections need not be legal in nature; the debtor might simply ask for mercy on the ground that, notwithstanding the existence of a default, a foreclosure would impose hardship. In some cases, the meeting may result in a workout agreement, with a modified payment schedule or some other form of relief to the debtor.

At a minimum, the meeting procedure should eliminate some foreclosures that would have been based on miscommunication or faulty records. It is not unusual for such mistakes to occur,

203. *Id.* § 206(c).

204. *See, e.g.*, FED. R. CIV. P. 52(a) (noting that in bench trials, “the court shall find the facts specially and state separately its conclusions of law thereon”).

205. *Id.*

206. For example, if the default is failure to pay property taxes, the lender might present a copy of a notice of delinquency from the taxing authority or a copy of the lender’s check paying the taxes on the borrower’s behalf.

207. UNFA art. 2, § 206(c).

particularly when secondary market servicing is transferred from an originating lender to a separate servicer, or from one servicer to another.²⁰⁸ One might expect that a debtor in such a situation would be assertive in calling the problem to the lender's attention, even in the absence of UNFA's meeting-to-object procedure. But the value of the meeting to object is that it compels the lender to assign a live human being to address the debtor's assertions—something that otherwise might be quite difficult to ensure.²⁰⁹

However, a meeting to object is not held automatically. The notice of foreclosure will inform the debtor of the right to a meeting,²¹⁰ but the debtor is responsible for making the request in writing.²¹¹ It seemed unreasonable to the drafters to force the scheduling of a meeting, with its attendant cost to the foreclosing creditor, in every case, because in most situations the borrower would probably have little or nothing to present. Requiring the borrower to take the initiative in requesting the meeting seems acceptable even when a governmental entity is foreclosing and due process requirements apply.²¹²

208. See, e.g., *Hibernia Sav. Bank v. Bomba*, No. 621, 1991 WL 35230, at *2 (Mass. App. Div. Apr. 18, 1991) (describing a mortgage holder that refused to honor its promise of a moratorium on payment made by its servicer).

209. See, e.g., *Colman v. Wendover Funding, Inc.*, No. 95-8051, 1996 U.S. App. LEXIS 14251, at *5 (10th Cir. June 12, 1996) (“[The borrower] never received any understandable reply or explanation of the balance owing or calculations of the default amounts.”); *Sutherland v. Barclays Am./Mortgage Corp.*, 61 Cal. Rptr. 2d 614, 625 (Ct. App. 1997) (featuring a borrower who alleged “that she had to deal with multiple representatives of the lender, was asked to submit the same materials on more than one occasion, received the wrong form letters, was ‘harassed’ to make payments she did not owe, and was improperly threatened with foreclosure”); *Sec. Pac. Nat’l Bank v. Robertson*, No. CV 920124622S, 1997 WL 561235, at *2 (Conn. Super. Ct. Aug. 28, 1997) (featuring a lender who allegedly “failed to disclose to the [borrowers] a person with authority to contact in order to work out a short payoff, or to compromise the debt”).

210. UNFA art. 2, §§ 204(b)(10)–(11). The notice will advise the debtor of the right to assistance from another person at the meeting, the last date on which a request for a meeting must be received by the foreclosing creditor, and the name, address, and telephone number of a representative of the creditor to whom the request for a meeting can be directed. The notice must also contain a statement “that a default exists under the security instrument and the facts establishing with particularity the default.” *Id.* § 204(b)(5). This information should permit the debtor to prepare for the meeting.

211. *Id.* § 206(a). The request must be received by the creditor within thirty days after the notice of foreclosure is issued.

212. In *United States v. Ford*, 551 F. Supp. 1101 (N.D. Miss. 1982), the borrowers received a letter inviting them to contact the district director of the Farmers Home Administration (their lender) to set up a meeting if they believed that foreclosure was improper. They did not do so, and the court had no difficulty finding that they had

It has become common for mortgage holders to transfer the servicing of their loans to centralized servicers who handle large numbers of loans, spread over many states, from a single location. In recognition of this practice, UNFA permits the meeting to object to be held telephonically rather than in person. Because in every case the relevant documents demonstrating a default must be provided to the debtor, the foreclosing creditor must put those documents in the debtor's hands by mail, courier, or facsimile before a telephonic meeting begins.

The drafters went to some lengths to ensure that neither party would be prejudiced in later litigation by participating in the meeting to object. The objective was to maximize the probability of free and open communication at the meeting. Thus, neither the grounds for foreclosure stated by the lender nor the defenses or objections raised by the debtor can limit the grounds or objections asserted in subsequent litigation.²¹³ The statements and representations of both parties presented in the meeting to object are off-the-record and cannot be used against them in later proceedings. Finally, requesting or participating in the meeting cannot give rise to liability on the part of the debtor, and making a decision adverse to the debtor cannot give rise to any independent liability on the part of the foreclosing creditor.²¹⁴ Of course, if the foreclosure is wrongful, the lender may be held liable in damages or may have the foreclosure set aside;²¹⁵ however, an adverse determination based on the meeting to object will not add to that liability.

It is arguable that the drafters should have expanded the scope of the meeting-to-object provisions of UNFA in two respects. First, they

waived their right to a hearing by failing to respond to notices mailed to them. . . . It is manifest that the [borrowers] were apprised of their rights and the impending foreclosure, and understood their options, yet they failed to take any action to seek a hearing and present reasons for having the foreclosure postponed. By making no effort to contact [Farmers Home Administration] officials to be heard, the [borrowers] waived their fifth amendment rights to a hearing.

Id. at 1105. By way of contrast, it has sometimes been assumed that, when due process is applicable, it is not sufficient to point out the debtor's right (generally available under common law principles, and provided by statute in some jurisdictions) to bring an action to enjoin the foreclosure, and in so doing to obtain a hearing. *Cf. In re Burgess*, 267 S.E.2d 915, 918 (N.C. Ct. App. 1980) (holding that the ability to seek an injunction satisfies the debtor's due process hearing right).

213. UNFA art. 2, § 206(c).

214. *Id.* § 206(d).

215. NELSON & WHITMAN, *supra* note 17, at 605–16 (discussing the available remedies for a defective power of sale foreclosure); *see also infra* notes 375–90 and accompanying text.

might have broadened the Act to apply to nonresidential debtors. The Act implicitly assumes that nonresidential debtors are more likely than residential debtors to be represented by counsel, to recognize fallacious or unjustified attempts to foreclose, and to assert their rights aggressively. We think that these assumptions are plausible. Commercial borrowers are also somewhat less likely to be victims of sloppy or incompetent transfers of servicing, given that multiple transfers of servicing are not as common with nonresidential loans. Of course, whether the borrower is residential or commercial, the need for a due process hearing is equally strong when the government forecloses a mortgage. However, there is nothing in the Act to stand in the way of a government agency's providing a commercial borrower a meeting to object; the Act simply does not mandate such a meeting.

The other way in which the drafters might have expanded the meeting to object would have been to offer it to junior lienholders as well as debtors. There is a certain appeal to this notion, because in many cases junior lienors' economic stake in the property being foreclosed is greater than the debtor's. But the drafters concluded that it made little sense to offer junior lienholders the right to a meeting. Junior lienholders seem unlikely to have much to say at such a meeting because they would not ordinarily have possession of payment records, cancelled checks, receipts, correspondence, or other documents that might help establish the absence or waiver of a default on the part of the debtor. Including junior lienholders in the meeting to object might well muddy rather than clarify the waters and would very likely add to the expense of the foreclosing lender. If a government agency is foreclosing, junior interest holders quite arguably have the right to a due process hearing, although we know of no case so holding. The Act leaves the provision and structuring of such a hearing to the agencies involved without mandating it.

C. Other Protections for Residential Debtors

The remaining features of UNFA that provide special treatment to residential debtors are fairly minor in terms of policy implications and likely importance. These features are briefly addressed here to provide a convenient reference.

1. *Agreements Fixing Standards of Performance.* UNFA allows the parties to a security agreement to "determine the standards by which performance of an obligation under this [Act] is to be

measured if those standards are not manifestly unreasonable.”²¹⁶ This language permits parties to commercial mortgage loans some degree of increased flexibility in negotiating and drafting their agreements. However, this provision is inapplicable if any debtor in the transaction is a residential debtor. This exemption results from concern that creditors with superior bargaining power might take advantage of residential debtors.

2. *Double Notices.* UNFA generally requires that debtors be sent three notices in connection with a foreclosure. Two of these are always required: a notice of default²¹⁷ and a notice of foreclosure.²¹⁸ The third will vary depending on the method of foreclosure. If the foreclosure will be conducted by auction sale, a copy of the advertisement²¹⁹ must be sent to the debtor. Alternatively, if foreclosure will be accomplished by negotiated sale or appraisal, an appropriate notice specifying the sale price²²⁰ or appraised value,²²¹ and the amount the foreclosing creditor proposes to credit to the debtor and junior lienors on account of the property’s disposition, must be sent.

In foreclosures involving only nonresidential debtors, a single copy of each of these notices sent by ordinary mail is sufficient. However, when such notices are sent to residential debtors, they are entitled to two copies, one of which must be sent by registered or certified mail.²²² The purpose of the double-notice and registered or certified mail requirements is to attempt to overcome avoidance behavior. When consumers accept a loan and promise to repay it, they ordinarily have every expectation of being able to do so. Default is usually associated with problems that were not anticipated by either the debtor or the creditor when the loan was made: ill health, loss of employment, breakup of a domestic relationship, excessive debt service burden,²²³ or a combination of these

216. UNFA art. 1, § 104(d). The concept is borrowed from section 1-302 of the UCC.

217. UNFA art. 2, § 202.

218. *Id.* §§ 203–204.

219. UNFA art. 3, § 303(b).

220. UNFA art. 4, § 403.

221. UNFA art. 5, § 503.

222. UNFA art. 1, § 108(b). A return receipt is not required, although many foreclosing lenders or their counsel might consider it essential, given that it provides a convenient written record of the delivery.

223. There is considerable evidence of a correlation between consumer bankruptcy filing trends and consumer debt level and debt service burden; changes in these factors tend to result

factors.²²⁴ When consumers cannot pay their bills, they often develop feelings of inadequacy, hopelessness, and mental depression. Bad news seems to accumulate, and for some people it simply becomes unbearable.²²⁵ The simple act of opening an envelope containing a notice from a bank or other creditor—likely to contain more bad news—is avoided. The envelope may sit unopened on a desk or table for weeks or months.

But avoidance behavior can be disastrous when foreclosure is imminent. It raises a direct risk that debtors will lose their homes and may even become homeless. UNFA therefore uses the double-notice provision as a way of alerting borrowers that their homes are in jeopardy. When two notices are sent, there is a greater chance that one of them will actually be read. Recipients must sign for registered or certified letters, further increasing the chance that those letters will get attention. The notice of foreclosure must include an explanation of any workout or loss mitigation plan available from the foreclosing creditor;²²⁶ this feature may encourage at least some debtors to communicate with their lenders and find solutions, rather than passively allow the foreclosure to occur.

3. *Notices Unclaimed or Sent to Incorrect Addresses.* Two fundamental problems arise for creditors in sending notices to debtors. The first is determining an initial address to which the notice should be directed, and the second is deciding on a proper course to follow if an initial notice is returned undelivered. The first problem may seem easy to resolve; the creditor can use the debtor's address as it appears in the loan file. However, that address may have been obtained when the loan was made, some months or years earlier. The

in changes in the number of filings one year later. See Gordon Bermant & Ed Flynn, *Explaining the (Complex) Causes of Consumer Bankruptcy*, 20 AMERICAN BANKR. INST. J. 20, 20 (Sept. 2001) (“[D]ivorce rates partially predicted consumer [bankruptcy] filing rates.”). Of course, increases in consumer debt, in turn, may well be related to illness, domestic breakup, and job loss. The relationships among these factors are complex and difficult to isolate because of myriad and shifting state exemption statutes, Federal Bankruptcy Code amendments, other consumer protection statutes, and societal attitudes toward bankruptcy.

224. Little is known about the causes of consumer debt delinquency and insolvency. See Carolyn Curnock, *Insolvency Counseling—Innovation Based on the Fourteenth Century*, 37 OSGOODE HALL L.J. 387, 405–06 (1999) (questioning the usual explanations asserted in Canada).

225. See, e.g., *Jourdan v. Nationsbank Mortgage Corp.*, 42 P.3d 1072, 1076 (Alaska 2002) (“[Debtor] moved for and was granted an open-ended continuance based on an affidavit from her psychiatrist that for the time being she was ‘unable to deal with complex legal matters.’”).

226. UNFA art. 2, § 204(b)(12).

debtor who has moved since that time may have sent the creditor a notice of change of address, but such a notice can take numerous forms, some of them quite informal. For example, the creditor may become aware of an address change because of a telephone call from the debtor, a new address on the debtor's payment checks, a copy of a property tax bill showing a new address, or a personal visit in which the debtor informs some employee of the creditor of the change. Should the creditor be charged with notice from some or all of these sources, or only from a written notice sent by the debtor for that purpose?²²⁷

The second problem arises because mailed notices may not reach their intended recipients. One reason this often occurs is that addressees move without providing the foreclosing creditor with new addresses, conduct that is more likely when they cannot pay their bills. In such cases, the letter may be returned to the sender, stamped "No longer at this address" or "Moved—no forwarding address." Hence, the sender knows that the address used is no longer valid and can reasonably be expected to make some effort to determine a correct address and resend the notice. UNFA so requires, as we explain below.

There is, however, another common reason that the notice may not reach the intended recipient. Assume that the notice was sent by registered or certified mail, requiring the addressee's signature. If the letter carrier does not find the addressee, the carrier will leave a note indicating that the addressee may pick up the letter at the post office. The addressee, realizing or suspecting that the letter involves foreclosure or some financial delinquency, may intentionally avoid claiming it.²²⁸ The difficulty is that when a registered or certified letter is returned to the sender as unclaimed, it is impossible for the sender to know whether the addressee has moved or simply refused to claim the letter.

Case law, often based on the specific language of the relevant statute or the mortgage itself, varies widely in its approach to this dilemma. One view is that debtors (and even junior interest holders)

227. See, e.g., *Zeller v. Home Fed. Sav. & Loan Ass'n*, 471 S.E.2d 1, 2 (Ga. Ct. App. 1996) ("A telephone call, a notation on a file by an employee of [the creditor], and the receipt of payment by checks with the new address, do not show compliance with the [written notice] requirement.").

228. See, e.g., *Tamm v. Gangitano*, No. CV990175640S, 2001 WL 254265 at *4 (Conn. Super. Ct. Mar. 2, 2001) ("The undisputed evidence indicates also that the defendants may have asserted lack of notice in bad faith by purposefully not claiming the letter.").

should keep the senior mortgage lender informed of their address changes, and that if they fail to do so, notices delivered to original addresses should be treated as received. Similarly, debtors should be expected to claim their registered or certified letters. Under this view, it does not matter whether the intended recipient has moved or simply failed to claim the letter; in either case the recipient has acted irresponsibly, and the notice is treated as having been received.²²⁹ The alternative view, equally widely adopted, is that when the letter is returned for whatever reason, the foreclosing creditor has a duty to make a reasonable effort to locate the debtor's current address and send a further notice to any address identified through that effort.²³⁰

UNFA adopts a standardized approach to finding the correct address to which notice must be sent, both as an original matter and when the original letter is returned as undeliverable. First, the Act provides a hierarchy of informational sources to which the foreclosing creditor must resort in determining the initial address to which a notice must be sent. The first source that the creditor must use is the most recent address in the "security instrument or other document [given by the recipient to the creditor] in connection with a security instrument that contains an address."²³¹ This means that any written

229. *Id.* (stating that the lender gave sufficient notice by sending two letters by certified mail, even though the recipients claimed not to have received them); *Mueller v. Simmons*, 634 S.W.2d 533, 535 (Mo. Ct. App. 1982) (finding that notice was sufficient when the trustee sent a letter by certified mail and the post office notified the recipient to claim it, but the recipient failed to do so); *Southwest Nat'l Bank v. Carson*, No. 2044 of 1989, 1990 WL 274462 (Pa. Com. Pl. Feb. 20, 1990) (holding that sending notice to the debtor's last known address was sufficient, even if the debtor had moved, because the creditor had no duty to attempt to trace the debtor).

230. *See Horne v. Savers Fed. Sav. & Loan Ass'n*, 747 S.W.2d 580, 582 (Ark. 1988) ("The burden is on the party attempting service by publication to attempt to locate the [missing party and to show the court] that after diligent inquiry, [the party's] whereabouts remain[] unknown." (quoting ARK. R. CIV. P. 4(f) cmt. 12)); *Bank Mart v. Langley*, 474 A.2d 491, 493 (Conn. Super. Ct. 1984) (finding that when a letter is unclaimed, the creditor must provide evidence of "all the steps taken to determine whether notice by some other form could be given so that the court may make an independent determination of the adequacy of the notice"); *Sec. Pac. Fin. Corp. v. Bishop*, 704 P.2d 357, 360 (Idaho Ct. App. 1985) (setting foreclosure aside when notice by registered or certified mail was sent to the correct address but was unclaimed); *Barclays Am./Mortgage Corp. v. BECA Enters.*, 446 S.E.2d 883, 885 (N.C. Ct. App. 1994) ("[S]ervice by publication is authorized only when a party 'cannot with *due diligence* be served by personal delivery or registered or certified mail.'" (quoting N.C. R. Civ. P. 4(j1) (1990))); *Lewis v. Premium Inv. Corp.*, 535 S.E.2d 139, 142 (S.C. Ct. App. 2000) (striking down a notice of forfeiture of an installment contract that was returned to the vendor marked "unclaimed," and giving the debtor a further right of redemption).

231. UNFA art. 1, § 107(1)(A)(i), (B). Because "document" is defined as "a tangible medium on which information is inscribed," a telephone call will not be included, nor will an electronic mail message unless it is printed. *Id.* § 102(5).

communication from the recipient will be regarded as notice to the creditor of an address change; a payment check, for example, or a copy of a tax bill will do. On the other hand, oral communications will not count as adequate notice unless the lender's employees memorialize them in writing in the loan file.

If no address is available from these sources, the creditor must investigate the public real estate recordings and, if personal property is included as part of the collateral, UCC filings.²³² If these sources provide no address, the creditor must make "reasonable efforts" to determine a correct address.²³³ As a last resort, the creditor can use the address of the real estate collateral.²³⁴

Suppose a notice sent to one of these addresses is returned unclaimed or with a notation that the address is no longer valid. In either case, the creditor now knows that "the notice will not be received at the address to which the notice was directed,"²³⁵ and the creditor must make a "reasonable effort" to find a correct address and send a new copy of the notice to that address.²³⁶ UNFA does not explicitly define "reasonable effort," but the comment suggests that it would include "any forwarding address provided by the U.S. Postal Service, the use of at least one generally-used telephone directory for the area in which the recipient is believed to be located, and at least one internet search database."²³⁷ As technology develops, other reasonable methods might become available.

When a notice is returned and a second effort to send it to a correct address is made, a timing issue arises. The new notification must occur "promptly" after the correct address is identified,²³⁸ but that still might be substantially later than the date of the original notice. In the case of nonresidential debtors, time periods run from the date that the creditor gave the original notice,²³⁹ even though the recipient is obviously likely to receive the notice some considerable

232. *Id.* § 107(1)(A)(ii). If this effort fails, and if the addressee holds a lease on the property, the creditor can use the property address, plus any known apartment or unit number.

233. *Id.* § 107(1)(A)(iv).

234. *Id.* § 107(1)(A)(iii).

235. *Id.* § 108(e).

236. *Id.*

237. *Id.* § 108 cmt.

238. *Id.* § 108(e).

239. Notices by creditors under the Act are "given" when they are transmitted, not when received. Hence, if the U.S. mail is used, depositing the notice with the Postal Service constitutes "giving" the notice. *Id.* § 108(a)(4).

time after it would have arrived had the original address been correct.²⁴⁰

For example, assume a notice of default is given by a mortgage creditor to a debtor. The Act allows the debtor to cure the default for up to thirty days from the date that the creditor gave the notice.²⁴¹ Suppose, however, that the debtor moved without informing the creditor, and five days after the creditor mailed the notice, it is returned stamped “No longer at this address; no forwarding address available.” The creditor would then consult a current telephone directory, discover a new address for the debtor, and send a new copy of the notice of default. Because of the address error, the debtor might not receive the notice until, say, ten days or more after the original notice was mailed.

If all of the debtors are nonresidential, the thirty-day cure period runs from the date that the original notice was mailed.²⁴² This will have the effect of shortening the effective cure period, of course, but that is a penalty that nonresidential debtors must pay for failing to provide their creditors with current address information. However, the Act is more lenient toward residential debtors: the time for cure is computed from the date that the replacement notice is mailed, with a maximum time extension of forty-five days.²⁴³ This benefit to residential debtors is an acknowledgment that consumers are often less organized and punctilious in keeping their creditors informed than business borrowers. The extension would also apply to a debtor’s request for a meeting to object to the foreclosure, which the Act requires the debtor to make within thirty days from the date the foreclosure notice was given.²⁴⁴

4. *Right to Notice of Default and Cure Period.* In general, if a mortgage or promissory note so provides, a default may result in an immediate acceleration of the debt by the creditor. Acceleration, which must be accomplished by some affirmative act of the creditor, means that the entire debt—not merely the missed installment payments—becomes due. Once acceleration has occurred, the debtor can prevent foreclosure only by paying the full amount (including,

240. *Id.* § 108(e)(1).

241. UNFA art. 2, § 202(c).

242. UNFA art. 1, § 108(e)(1).

243. *Id.* § 108(e)(2).

244. UNFA art. 2, § 206(a).

typically, any accrued interest, late fees, attorneys' fees, and other expenses that the creditor has incurred), unless a statute expressly authorizes cure by payment of only the missed payments.²⁴⁵

This may seem unreasonable on its face. "Surely," most borrowers must think, "my lender cannot force me to pay off the loan under threat of foreclosure simply because I was one day late with one monthly payment." Perhaps most lenders would not exercise their right of acceleration in such a peremptory fashion, but it is reasonably clear that the right exists.²⁴⁶ A court might exercise equitable discretion by refusing to recognize the acceleration if the creditor's action was in bad faith²⁴⁷ or the debtor's default was inadvertent or due to factors beyond the debtor's control.²⁴⁸ However, debtors cannot rely on such discretion being exercised in their favor in any given case.

Why would a lender act in this fashion? Most lenders do not want to foreclose, and do so only as a last resort. But to see why the "hammer" of acceleration might fall, consider the following case. Assume that the borrower is a commercial entity with considerable financial strength. It has made all payments on the mortgage loan on time, and has complied with all of the other covenants in the mortgage. The loan has a fixed interest rate that approximated market level when it was made. However, a large run-up in interest rates has occurred since that time, and the loan is now several percentage points below current market rates. This loan is a sore spot with the lender. The lender's cost of funds has also increased, and now exceeds the interest rate on the loan; every day the loan continues in place represents a further economic loss.

245. The classic case is *Graf v. Hope Building Corp.*, 171 N.E. 884, 885–86 (N.Y. 1930), which found the acceleration effective although the default was brief and inadvertent. In a widely cited dissent, Judge Cardozo argued that default should have been excused. *Id.* at 886–89.

246. *Id.* at 885–86.

247. See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.1(d) (1997) ("A mortgagor may defeat acceleration [if] . . . the mortgagee has engaged in fraud . . ."). Although such mortgagee misconduct may be the basis for defeating acceleration, the "mortgagor's negligence, mistake, or improvidence are not." *Id.* § 8.1 cmt. e.

248. See *Fed. Home Loan Mortgage Corp. v. Taylor*, 318 So. 2d 203, 208 (Fla. Dist. Ct. App. 1975) (excusing a loan default when the mortgagor was in the Philippines in military service and had difficulty communicating with the mortgagee in the United States); *DiMatteo v. N. Tonawanda Auto Wash, Inc.*, 476 N.Y.S.2d 40, 41 (App. Div. 1984) (finding that inadvertent default raised factual questions that might prevent foreclosure).

Assume further that a payment on the loan arrives a day or two late. The reason for the payment's tardiness might be a clerical error by the borrower's staff, a storm or other natural disaster, or a delay in postal operations—perhaps another anthrax scare. Whatever the reason, the creditor realizes that it has an opportunity to get rid of a very undesirable loan. Perhaps some lenders would resist the temptation to accelerate, fearing that doing so would jeopardize a longstanding business relationship with the borrower, but lenders who have no such relationship or scruples might well drop the hammer. The borrower's real sin is not the default, but rather having too good a deal in economic terms—a deal that the lender is anxious to escape at the first opportunity.

The scenario above has little relevance to loans secured by individual residences. Throughout the nation, nearly all residential loans are written on the standard mortgage or deed of trust forms approved by Fannie Mae and Freddie Mac. Clause 22 of that form, although varying in details from state to state to accommodate variations in local law, uniformly provides that the borrower is entitled to written notice of any default and at least a thirty-day period to cure it.²⁴⁹ Acceleration can occur only if no cure is effected in the time allowed.²⁵⁰

In principle, nonresidential borrowers can negotiate similar notice and cure rights for themselves. In current practice, however, commercial mortgage loan documents usually make a distinction between monetary and nonmonetary defaults. For nonmonetary defaults, such as failure of the borrower to provide financial reports to the lender or to make timely repairs on the property, commercial mortgage lenders are nearly always willing to agree to give notice and a cure period (commonly ranging from ten to thirty days) before accelerating. With respect to monetary defaults, however, many lenders simply refuse to agree to any notice or cure period.²⁵¹

249. For links to state-specific mortgage forms, all of which allow a thirty-day period to cure default, see Fannie Mae/Freddie Mac, *Mortgage Documents Security Instruments*, at http://www.efanniemae.com/singlefamily/forms_guidelines/mortgage_documents/sec_instr.jhtml?role=ou (last visited Mar. 22, 2004) (on file with the *Duke Law Journal*).

250. See *Schaeffer v. Chapman*, 861 P.2d 611, 613–14 (Ariz. 1993) (holding that the thirty-day cure right provided by the Fannie Mae-Freddie Mac form must precede the ninety-day period between the notice of sale and the actual date of sale under Arizona law).

251. One of the authors negotiated about twenty commercial mortgage loans, ranging from \$1 million to \$20 million, on behalf of borrowers from 2001 to 2003. In every case, the loan documents as originally drafted by the lender made no provision for notice or cure of monetary defaults. In about one-third of those cases, the lender was persuaded to modify its forms to

External legal rules may also influence the availability of acceleration. A number of states have adopted “arrearages” statutes that prohibit acceleration of a mortgage loan until the borrower has been given notice and an opportunity to cure the default.²⁵² In some states, debtor protection takes the form of a two-notice system:²⁵³ the lender must first deliver a notice of default, wait a prescribed period, and then deliver a notice of foreclosure if no cure has been made. In a two-notice system, acceleration cannot occur until the notice of foreclosure is issued. Other states use a single notice—typically called a notice of foreclosure—but require the lender to rescind or terminate the notice or discontinue the foreclosure if cure is made

provide for such notice, but in the majority of cases the lender refused to make any change. Even when the borrower proposed a cure period as short as twenty-four hours and notice by telephone, fax, or electronic mail, most lenders refused.

252. *See, e.g.*, ALASKA STAT. § 34.20.070(b) (Michie 2002) (permitting cure any time prior to the foreclosure sale); CAL. CIV. CODE, § 2924c(b)(1) (West Supp. 2004) (permitting cure up to five days before the foreclosure sale); COLO. REV. STAT. § 38-38-104(a), (c) (2003) (permitting cure up to one day prior to the foreclosure sale, if the curing party gives notice of intent to cure at least fifteen days prior to the sale); D.C. CODE ANN. § 42-815.01(b) (Supp. 2004) (permitting cure for residential loans up to five days prior to the sale); HAW. REV. STAT. ANN. § 667-28(c) (Michie 2002) (permitting cure up to three business days before the sale); IDAHO CODE § 45-1506(12) (Michie 2003) (permitting cure up to 115 days from the recording of the notice of default); 735 ILL. COMP. STAT. ANN. 5/15-1602 (West 2003) (permitting cure up to ninety days from the date of service of process in the foreclosure action); IOWA CODE ANN. § 655A.3 (West Supp. 2004) (permitting cure for thirty days after receipt of the default notice); MINN. STAT. ANN. § 580.30 (West 2000) (permitting cure up to the time of the foreclosure sale); MO. ANN. STAT. § 408.555(4) (West 2001) (permitting cure up to the time of the foreclosure sale, for certain junior residential mortgages only); MONT. CODE ANN. 71-1-312(1) (2003) (permitting cure up to the time of the foreclosure sale, for small tracts only); NEV. REV. STAT. ANN. 107.080(2)(a)(2) (Michie Supp. 2003) (permitting cure for thirty-five days after the recording and mailing of the default notice); OKLA. STAT. ANN. tit. 46, § 44 (West 1996) (permitting cure for thirty-five days after the sending of the default notice); OR. REV. STAT. § 86.753 (2003) (permitting cure up to five days before the date set for the foreclosure sale); 41 PA. CONS. STAT. ANN. § 404 (West 1999) (permitting cure up to one hour before the commencement of the judicial foreclosure sale, for residential mortgages only); TEX. PROP. CODE ANN. § 51.002(d) (Vernon Supp. 2004) (permitting cure for twenty days after sending of the default notice); UTAH CODE ANN. § 57-1-31 (Supp. 2004) (permitting cure within three months of the date of filing of the default notice); WASH. REV. CODE ANN. § 61.24.090(1) (West 2004) (permitting cure up to eleven days prior to the scheduled date of the foreclosure sale).

Except for the District of Columbia, the creation of a statutory right to cure is largely a Midwestern and Western phenomenon. We have identified no right to cure without acceleration in Alabama, Arizona, Georgia, Maine, Massachusetts, Michigan, Mississippi, New York, Rhode Island, South Dakota, Tennessee, Virginia, West Virginia, or Wyoming.

253. States with two-notice systems include California, Nevada, Oklahoma, Utah, and Washington. *See supra* note 252.

within a specified period.²⁵⁴ Again, “cure” here means payment of the unaccelerated delinquent amounts, plus any attorneys’ fees and costs expended by the creditor.²⁵⁵

UNFA represents the view that it is fundamentally unfair to give a creditor a right to accelerate upon default with absolutely no opportunity for the debtor to cure. A minor default may occur even if the debtor is extremely careful, well-managed, and solvent, and the results of such an acceleration can be financially catastrophic, potentially forcing the debtor to refinance under extremely adverse economic conditions at a much higher interest rate.

UNFA implements the right to cure by employing a two-notice system. The secured creditor must first give the debtor a notice of default, specifying the nature of the default and advising the debtor of the amount of time allowed for cure.²⁵⁶ That time is ordinarily thirty days, but if the default is not monetary and a debtor promptly commences to cure and diligently proceeds, a period of ninety days is allowed to complete the cure.²⁵⁷ The thirty-day period can be reduced by agreement to as little as ten days if the security does not include any residential real property.²⁵⁸ If a cure is made (either within the allowed time period or after it has expired but before an acceleration), no notice of foreclosure can be given and any purported acceleration on account of that default is ineffective.²⁵⁹ The cure right provided by UNFA runs concurrently with any cure right provided in the security instrument itself, and the longer of the two governs.²⁶⁰ For example, if the instrument allows a sixty-day cure period for monetary defaults, it will prevail over the thirty-day period allowed by UNFA.

254. States following this model include Alaska, Colorado, Illinois, Minnesota, Oregon, and Pennsylvania. *See supra* note 252.

255. Alaska’s statute is typical of such provisions: “[T]he default may be cured by payment of the sum in default other than the principal which would not then be due if no default had occurred, plus attorney fees or court costs actually incurred by the trustee due to the default.” ALASKA STAT. § 34.20.070(b).

256. UNFA art. 2, § 202(b).

257. *Id.* § 202(c). The thirty-day period was selected as consistent with that allowed by the standard Fannie Mae-Freddie Mac residential mortgage and deed of trust forms. *See supra* note 249 and accompanying text. If no one is diligently pursuing cure of a nonmonetary default thirty days after the giving of the notice, the creditor is authorized to terminate the cure period and accelerate the debt immediately. *Id.* § 202(d).

258. *Id.* § 202(e).

259. *Id.* § 202(h).

260. *Id.* § 202(g).

The notice and cure provisions of UNFA might be criticized on the ground that the notice of default must be given only to debtors, and not to holders of junior interests who might be willing to cure. Indeed, it is not unusual for junior lienholders or tenants to have a greater financial stake at risk in foreclosure than the debtor. They may have a greater financial capacity to cure the default as well. Nonetheless, under UNFA only debtors are entitled to a notice of default. This is consistent with the usual practice in states using a two-notice system, all of which direct the preliminary notice only to the debtor.²⁶¹ Of course, if a junior lienholder or tenant nonetheless cures the default, the cure is effective to prevent foreclosure.

The principal argument for limiting the notice of default to the debtor is that it minimizes the creditor's costs. The creditor nearly always has an address in its files for the debtor, but is unlikely to know the identities or addresses of subordinate interest holders without going to the expense and trouble of obtaining a title examination. To cure the default, the curing party will have to pay the creditor's expenses as well as the delinquent payments. Hence, limiting the notice of default to debtors reduces costs and makes a cure more feasible. In many cases, junior interest holders will learn about the default from the debtor (perhaps because the debtor has also defaulted on the junior obligations). This will not always be so, but UNFA's approach nonetheless seems an acceptable compromise.

IV. THE PROBLEM OF THE "OMITTED JUNIOR"

Foreclosures, whether judicial or by power of sale, are sometimes conducted imperfectly. One common error is the failure of the foreclosing creditor to join as parties (in a judicial foreclosure) or to give notice of the foreclosure (in a power of sale foreclosure) to one or more subordinate interest holders. Although such interest holders are usually described loosely as junior lienors, they may in fact hold interests other than liens, such as leases, easements, or covenants. The

261. *See, e.g.*, CAL. CIV. CODE § 2924b(b)(1) (West Supp. 2004) (requiring that notice of default be sent to "each trustor or mortgagor," as well as to persons who have recorded a request for notice); NEV. REV. STAT. ANN. 107.080(3) (Michie Supp. 2003) (requiring notice "to the grantor, and to the person who holds the title of record"); OKLA. STAT. ANN. tit. 46, § 44 (West 1996) (mandating notice "to the mortgagor"); TEX. PROP. CODE ANN. § 51.002(d) (Vernon Supp. 2004) (requiring notice to "the debtor in default"); UTAH CODE ANN. § 57-1-26 (Supp. 2004) (requiring that notice be mailed to the address of either the trustor or the property); WASH. REV. CODE ANN. § 61.24.030(7) (2004) (mandating notice to "the borrower and grantor").

omission of these interest holders is usually the result of an error by the examiner who was employed to search the title in preparation for the foreclosure.

In some cases, however, the foreclosing creditor may quite consciously and intentionally omit a party. In nearly all of those cases, the omitted party is a tenant holding a lease on the property that is subordinate to the mortgage being foreclosed. Often the creditor has evaluated the lease and concluded that its continuation after the foreclosure is desirable and will add to the property's value. Hence, the creditor's objective in omitting the tenant is to preserve the lease from the terminating effect of the foreclosure.

Existing foreclosure statutes, both those dealing with judicial foreclosure and those authorizing nonjudicial foreclosure, generally fail to deal adequately with the results of omitting a junior party. The courts have been forced to fill in the gaps. In doing so, they have balanced the economic interests at stake with varying degrees of success. By contrast, UNFA sets out the law unambiguously.

In this Part, we first consider how the courts have dealt with the problem of the omitted junior party and compare those judicial rules with UNFA's position. We then give particular attention to preservation of junior leases, a topic that has engendered much judicial confusion. We analyze UNFA's approach, which gives the foreclosing creditor a great deal of flexibility in deciding whether the foreclosure will terminate junior leases.

Finally, we consider UNFA's treatment of *unrecorded* junior leases. Such leases can be extremely problematic to foreclosing creditors, but their treatment under existing nonjudicial foreclosure statutes is generally a muddle. To cut off unrecorded leases under UNFA, a foreclosing creditor must provide notice to the tenants only if the creditor has knowledge of their existence. If the foreclosing creditor is unaware of the unrecorded tenants, their leases can be terminated by foreclosure without any notice. Constructive notice is not imputed to the creditor from the tenant's possession. We conclude that this approach is consistent with the reasonable expectations of the parties and the overall fairness of the foreclosure system.

A. *The Judicial Foreclosure Analogy*

When foreclosures are conducted judicially, the courts have carefully worked out the rights of omitted parties and the impact of

these rights on the foreclosure process. The foreclosure sale transfers to the purchaser the rights of all nonomitted parties, including the mortgagor and the foreclosing mortgagee,²⁶² and the foreclosure is valid and effective despite failure to join the subordinate party.²⁶³ However, the omitted party's lien or interest is not affected by the foreclosure. Hence, after the foreclosure, the omitted party retains all of the rights that it had previously. For example, the omitted party can redeem the original senior mortgage (which is regarded as continuing to exist for this purpose), just as it could have done before the foreclosure, forcing a transfer of the mortgage rights to the omitted party. But because the original mortgagee's rights have now been transferred to the foreclosure purchaser, the omitted party must redeem from the foreclosure purchaser rather than the original mortgagee.²⁶⁴ Alternatively, if the omitted party holds a lien, it can foreclose that lien against the original mortgagor's rights; once again, those rights are now held by the foreclosure purchaser.²⁶⁵ Finally, the omitted party, if it is owed a liquidated sum, can seek to recover that amount from any surplus foreclosure proceeds in the hands of the mortgagor—obviously a long shot at best.²⁶⁶

262. See *Downstate Nat'l Bank v. Elmore*, 587 N.E.2d 90, 93 (Ill. App. Ct. 1992) (finding that when a comortgagor was omitted as a party to the foreclosure action, the foreclosure was ineffective as to his interest and a junior mortgagee's claim on his interest).

263. See, e.g., *W. Bank v. Fluid Assets Dev. Corp.*, 806 P.2d 1048, 1052–53 (N.M. 1991) (preserving a junior mortgage when the junior mortgagee was not a party to the foreclosure); *United States Bank of Wash. v. Hursey*, 806 P.2d 245, 247–48 (Wash. 1991) (permitting a first mortgagee to bring a reforeclosure action against a junior mortgagee who was inadvertently omitted from receiving notice of the first foreclosure); *Patel v. Khan*, 970 P.2d 836, 839 (Wyo. 1998) (finding that a junior mortgagee's interest survived the foreclosure of a senior mortgage because the junior mortgagee was not made a party to the proceeding). For a thorough discussion, see also NELSON & WHITMAN, *supra* note 17, at 572–80.

264. See *Diamond Benefits Life Ins. Co. v. Troll*, 77 Cal. Rptr. 2d 581, 586–87 (Ct. App. 1998) (entitling an omitted junior easement holder to redeem from the foreclosure purchaser); *Akeley v. Miller*, 264 So. 2d 473, 473–74 (Fla. Dist. Ct. App. 1972) (entitling an omitted junior lienholder to redeem from a foreclosure purchaser); *Kuehl v. Eckhart*, 608 N.W.2d 475, 477 (Iowa 2000) (same); *W. Bank*, 806 P.2d at 1052 (same).

265. See *Lenexa State Bank & Trust Co. v. Dixon*, 559 P.2d 776, 783–84 (Kan. 1977) (finding that holders of mechanics' liens omitted from the foreclosure of the senior mortgage could foreclose against the purchaser at the senior sale); *Pease Co. v. Huntington Nat'l Bank*, 495 N.E.2d 45, 49 (Ohio Ct. App. 1985) (“Where a senior mortgagee forecloses his mortgage and sells the property without notice to the junior mortgagee, the purchaser acquires title subject to the rights of the junior mortgagee, which remain unaffected by the sale.”).

266. See *Caito v. United Cal. Bank*, 576 P.2d 466, 469 (Cal. 1978) (“[S]ubordinate liens . . . attach to the surplus proceeds [of foreclosure] in order of their priority.”); *Soles v. Sheppard*, 99 Ill. 616, 621 (1881) (holding that a junior encumbrancer who was omitted from a senior mortgage foreclosure could participate in the surplus from the senior sale).

The foreclosure purchaser, on the other hand, has several options: The purchaser can exercise the rights of the original mortgagor, redeeming the omitted junior interest (if it is a mortgage or lien).²⁶⁷ Alternatively, the purchaser can exercise the rights of the original mortgagee, reforeclosing the mortgage but this time making the formerly omitted interest holder a party.²⁶⁸ Yet another option for the foreclosure purchaser is to seek a judicial decree of “strict foreclosure,” cutting off the omitted interest entirely.²⁶⁹

Despite their complexity, these rules are fair and work well. They have the advantage of not “throwing the baby out with the bath water”—that is, they do not void the entire foreclosure proceeding because of the omission of a subordinate party; instead, they preserve the rights of such parties while validating the rest of the procedure.

The problem of the omitted party also arises in designing power of sale foreclosure procedures. In power of sale foreclosures, giving a notice of foreclosure serves the same purpose as does service of process in judicial proceedings. What is the result of failure to give the statutorily required notice to a junior interest holder? In roughly half of the existing power of sale statutes, the question does not arise because there is no requirement that the holders of junior interests be given any notice at all.²⁷⁰ In those states, the concept of omitting a

267. See *Portland Mortgage Co. v. Creditors Protective Ass'n*, 262 P.2d 918, 922–25 (Or. 1953) (affirming a foreclosure purchaser's right to redeem property from an omitted junior lien); *Murphy v. Farwell*, 9 Wis. 97, 103–04 (1859) (same).

268. See *Diamond Benefits Life Ins. Co.*, 77 Cal. Rptr. 2d at 585–86 (entitling a foreclosure purchaser to foreclose against an omitted junior easement holder); *First Fed. Sav. & Loan Ass'n v. Nath*, 839 P.2d 1336, 1340–41 (Okla. 1992) (entitling a foreclosure purchaser to foreclose against an omitted property lien).

269. *But see Miami-Dade County v. Imagine Props., Inc.*, 752 So. 2d 129, 130 (Fla. Dist. Ct. App. 2000) (holding that a senior foreclosure purchaser's suit for strict foreclosure of an omitted junior lien held by the county was subject to preemption by the county's redemption of property from a senior purchaser). Strict foreclosure should be available only upon a showing that the junior lien has little or no value. See *Miles v. Stehle*, 36 N.W. 142, 143 (Neb. 1888) (approving strict foreclosure when the property was worth no more than the other liens against it); *Mesiavech v. Newman*, 184 A. 538, 539–40 (N.J. Ch. 1936) (same); RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.1 cmt. b (1997) (acknowledging a presumption against “strict foreclosure” remedies).

270. Jurisdictions that do not require notice to subordinate interest holders in power of sale foreclosures include Alabama, the District of Columbia, Georgia, Maine, Michigan, Minnesota (unless the junior interest holder is in possession, MINN. STAT. ANN. § 580.03 (West 2000)), Missouri, Nevada, New Hampshire, Rhode Island, Tennessee, Texas, Utah (although notice posted on the property may come to the attention of junior interest holders in possession, UTAH CODE ANN. § 57-1-25(1)(b) (Supp. 2004)), West Virginia (unless the junior interest holder has notified the foreclosing creditor of the interest, W. VA. CODE ANN. § 38-1-4 (Michie 1997)), and Wyoming. In some of the jurisdictions mentioned, the absence of required notice is mitigated by

junior party is meaningless. The drafters of UNFA quickly rejected this approach. It is questionable in terms of fundamental fairness and hard to justify in comparison with the protection provided to omitted juniors in judicial foreclosure. Moreover, the UNFA drafters wished to produce a statute that would be constitutional when applied in foreclosures by government agencies, and it seemed quite likely that a statute lacking a provision for notice to the holders of subordinate interests that would be cut off by foreclosure would fail the due process standard.²⁷¹

For this reason, UNFA requires that notice of foreclosure be given not only to debtors and their agents, but also to junior interest holders known to the foreclosing creditor or identifiable through the public records.²⁷² It also requires notice to persons who have recorded a request for notice in the public records and places no restrictions on who can record such a request.²⁷³ There is no provision for notice to holders of interests senior to the security instrument being foreclosed. This is consistent with the current practice in judicial foreclosure, which ordinarily does not require joinder of senior parties because their rights are unaffected by foreclosure. In all of these respects, UNFA establishes rules closely analogous to those governing judicial foreclosure.

A power of sale foreclosure statute that, like UNFA, requires notice to junior parties must consider what consequences should flow from failure to provide the required notice. It appears that only one existing statute in the United States directly addresses this question²⁷⁴—a rather surprising drafting lapse. In effect, the great majority of statutes provide a list of persons whom creditors must notify, but they contain no information about what results ensue if a creditor fails to give the statutorily required notice. The one exception is Washington state, which adopted a statute addressing the results of failure to notify junior parties in response to *Glidden v.*

the statutory right of any person, including the holder of a subordinate interest, to record a request for notice of the foreclosure of a particular security interest and thereby become entitled to receive one.

271. See *Ricker v. United States*, 417 F. Supp. 133, 138 (D. Me. 1976) (“To be adequate, notice ‘must be such as is reasonably calculated to reach interested parties.’ The newspaper foreclosure notices, which the [mortgagors] did not see, plainly failed to meet this standard.” (citations omitted)).

272. UNFA art. 2, § 203(c).

273. *Id.* § 205.

274. WASH. REV. CODE ANN. § 61.24.040(7) (West 2004). See *infra* notes 275–78 and accompanying text.

Municipal Authority of Tacoma.²⁷⁵ In *Glidden*, the trustee of a deed of trust held by the municipal authority commenced a nonjudicial foreclosure proceeding. The trustee failed to notify Old Stone Bank, which held a junior deed of trust on the property, although she advised the municipal authority on several occasions that she had sent notice to all of the junior interest holders as required by the statute.²⁷⁶ The municipal authority purchased the property at the foreclosure sale, and the foreclosure deed recited that all junior interest holders had been notified. An unsuccessful bidder, joined by the trustee, subsequently brought a suit to set aside the sale.

The court approached the case by referring to the Washington statute that imposes a conclusive presumption in favor of bona fide purchasers that the foreclosure procedure has met the statutory requirements.²⁷⁷ For the court, the issue was whether the municipal authority was a bona fide purchaser,²⁷⁸ and the court ultimately remanded the case for a finding of fact on that point. The court did not clarify whether the sort of “omitted junior” analysis that would have applied to a judicial foreclosure should apply similarly in the power of sale context if the foreclosure purchaser was not found to be

275. 758 P.2d 487 (Wash. 1988).

276. The Washington statute requires that notice of foreclosure be given to “[t]he beneficiary of any deed of trust or mortgagee of any mortgage, or any person who has a lien or claim of lien against the property, that was recorded subsequent to the recordation of the deed of trust being foreclosed and before the recordation of the notice of sale.” WASH. REV. CODE § 61.24.040(1)(b)(ii).

277. *Glidden*, 758 P.2d at 490 (referring to WASH. REV. CODE § 61.24.040(7)). The presumption in Washington applies only if the foreclosure deed recites compliance, as it did in the *Glidden* case.

278. What power of sale foreclosure purchasers must do to qualify as bona fide purchasers is debatable. If the purchasers have obtained their own title examination reports (as purchasers at judicial sales are always expected to do), it is then a simple matter for the purchasers to compare the names of the parties listed in the report with those to whom notice was actually given, as reflected in the pleadings. However, it may not be customary for bidders at power of sale foreclosures to make a similar examination of the notices that have been issued. As one highly experienced Washington practitioner reported to the authors:

As a practical matter one [who is planning to bid] must (should) inspect the trustee’s files. Whenever I represent a purchaser, I inspect the trustee’s file to review the trustee guarantee (title foreclosure report) and the supplemental (post lis pendens—Notice of trustee sale) and then I check for evidence of service on the correct parties. On foreclosures we conduct, prospective purchasers often ask for copies of our trustee reports, but rarely do they take the extra step to see if we have done our job and actually served all the necessary parties.

E-mail from John Gose, Senior Counsel, Preston Gates & Ellis L.L.P. Seattle, Wash. to Grant S. Nelson & Dale A. Whitman (Aug. 25, 2003) (on file with the *Duke Law Journal*).

a bona fide purchaser.²⁷⁹ This oversight motivated real estate lawyers in Washington to seek an immediate statutory amendment, enacted in 1989, providing:

[T]hese recitals shall not affect the lien or interest of any person entitled to notice under RCW 61.24.040(1), if the trustee fails to give the required notice to such person. In such case, the lien or interest of such omitted person shall not be affected by the sale and such omitted person shall be treated as if such person was the holder of the same lien or interest and was omitted as a party defendant in a judicial foreclosure proceeding.²⁸⁰

Hence, the Washington legislature ultimately made the rules for nonjudicial and judicial foreclosure identical with respect to omitted junior parties, an entirely sensible result.

However, without a clear statutory statement on the issue, other state courts have been unwilling to reach the same conclusion in the context of nonjudicial foreclosure. Three other jurisdictions, Nevada,²⁸¹ Minnesota,²⁸² and Missouri,²⁸³ have concluded that when no notice is given to a party who is entitled by statute to notice, the entire foreclosure is void. This result reflects a sort of mindless logic, disregarding the parties' needs and necessitating more work than is really necessary to balance the interests of foreclosing creditors and junior interest holders.²⁸⁴ Analogizing power of sale foreclosures to judicial foreclosures, as UNFA does, makes much more sense.

279. *Glidden*, 758 P.2d at 490.

280. WASH. REV. CODE ANN. § 61.24.040(IX)(7).

281. *Title Ins. & Trust Co. v. Chi. Title Ins. Co.*, 634 P.2d 1216, 1218 (Nev. 1981) (holding that when a vendee under a long-term installment purchase contract was a "successor in interest" of a trustor and therefore entitled to notice of nonjudicial foreclosure, the failure to give such notice rendered the foreclosure void).

282. *Ledgerwood v. Hanford*, 214 N.W. 925, 926 (Minn. 1927) (voiding the foreclosure when the purchaser failed to give notice to the holder of a subordinate lease).

283. *Williams v. Kimes*, 996 S.W.2d 43, 45–46 (Mo. 1999) (finding null and void a power of sale foreclosure by deed of trust without notice to the holders of a contingent remainder in the property). Missouri does not require notice of foreclosure to subordinate interest holders. MO. REV. STAT. § 443.325(3) (2000). However, the omitted party in *Williams* was the holder of a contingent remainder in the property, and thus was entitled to notice as an "owner." 996 S.W.2d at 45–46. *See also infra* notes 306–10 and accompanying text.

284. It appears that in these cases both the attorneys and the court were unfamiliar with the analogy of the omitted junior party in a judicial foreclosure; there is no indication in either opinion that such reasoning was argued or considered.

B. Preserving Junior Leases

The ability to omit a junior party is particularly useful to a foreclosing creditor when the junior interest is a subordinate lease that the creditor wishes to preserve from the extinguishing effect of foreclosure. Junior leases are essentially different from junior liens because they represent both a burden (the continuing possession of the tenant) and a benefit (the rent that the tenant is obligated to pay). A lease may be highly advantageous and add significantly to the property's value, particularly if its rent is at market level or above and the tenant is solvent and pays reliably. If the continuation of such a lease can be assured, the property is likely to sell in foreclosure for more than if it were vacant. Thus, the ability to preserve junior leases is potentially advantageous to the foreclosing creditor, other junior lienholders, and the debtor. By comparison, junior liens are only a burden, and every foreclosing creditor wants to pass title in the foreclosure sale free of them.

In the judicial foreclosure setting, American jurisdictions are about equally divided as to whether the foreclosing creditor can preserve a junior lease against the will of the tenant. The creditor may intentionally fail to serve the tenant as a party to the foreclosure,²⁸⁵ but in about half of the states courts nonetheless consider the lease terminated automatically or allow the omitted tenant to intervene in order to be terminated by the foreclosure.²⁸⁶ States following this approach are known as "automatic termination" jurisdictions. The states that do not recognize such automatic termination or intervention, therefore allowing the foreclosing creditor to decide

285. See *Como, Inc. v. Carson Square, Inc.*, 648 N.E.2d 1247, 1249–50 (Ind. Ct. App. 1995) (holding that a junior tenant who is not made a party to a judicial foreclosure is unaffected by it). The Indiana Supreme Court divided equally on the issue, leaving the court of appeals opinion as the law of the case. See *Como, Inc. v. Carson Square, Inc.*, 689 N.E.2d 725, 726 (Ind. 1997).

286. See, e.g., *Beach v. Beach Hotel Corp.*, 156 A. 865, 866 (Conn. 1931) (finding a lease extinguished after a property sale); *City Bank & Trust Co. v. Thomas*, 735 S.W.2d 121, 122 (Mo. Ct. App. 1987) (same); *Hembree v. Mid-Am. Fed. Sav. & Loan Ass'n*, 580 N.E.2d 1103, 1109 (Ohio Ct. App. 1989) (same). See also *National Bank of North America v. Gloucester Equities, Inc.*, 372 N.Y.S.2d 348, 348–49 (Sup. Ct. 1975), which apparently requires foreclosing mortgagees to name and serve all subordinate tenants in a judicial foreclosure action. The ruling, if a correct statement of New York law, effectively prevents mortgagees from "picking and choosing."

whether a particular lease will be terminated or not, are usually termed “pick and choose” states.²⁸⁷

There is nothing unfair or inefficient about permitting the foreclosing creditor to make this decision. If the landlord is not in default under the lease, there is no reason to permit the tenant to escape the lease merely because the landlord has failed to pay its obligations to a mortgage lender. Although it is in the nature of being subordinate in priority that the tenant is *at risk* of having the lease terminated in the event of foreclosure,²⁸⁸ it does not follow that the tenant should be able to *demand* to have it terminated. To allow the tenant to do so might give the tenant an unanticipated windfall, while at the same time significantly devaluing the real estate and depriving the creditor of its bargained-for security. To forestall this result, mortgage creditors sometimes negotiate “attornment” agreements with junior tenants in which each tenant covenants not to attempt to terminate the lease in the event of a mortgage foreclosure.²⁸⁹ These agreements are very helpful to lenders in “automatic termination” states, but they are far from universal.

In the context of nonjudicial foreclosure, a creditor’s ability to preserve junior leases is often impossible to predict, because in many states neither the case law nor the foreclosure statutes provide clear answers. However, one undesirable effect of holdings like those mentioned above in Nevada, Minnesota, and Missouri—that failure to name all parties specified by the foreclosure statute renders the foreclosure void—is to make “picking and choosing” impossible in

287. See, e.g., *Citizens Bank v. Bros. Constr. & Mfg., Inc.*, 859 P.2d 394, 396–97 (Kan. Ct. App. 1993) (requiring the joinder of a junior leaseholder before the leaseholder’s interests could be terminated and thereby permitting the mortgagee to avoid termination by failing to join the leaseholder); see also Robert D. Feinstein & Sidney A. Keyles, *Foreclosure: Subordination, Non-Disturbance and Attornment Agreements*, PROB. & PROP., July–Aug. 1989, at 38, 39–40 (describing agreements made by tenants to avoid the risk of lease termination in “pick and choose” jurisdictions).

288. A tenant who is unwilling to accept the risk of termination can attempt to negotiate a “nondisturbance” agreement with the senior creditor, assuring the tenant that the lease will not be terminated upon foreclosure. Such an agreement was upheld in *KVR Realities, Inc. v. Treasure Star, Inc.*, 459 N.Y.S.2d 258, 259 (1983).

289. See, e.g., *Miscione v. Barton Dev. Co.*, 61 Cal. Rptr. 2d 280, 288 (Ct. App. 1997) (enforcing an attornment agreement in a lease). Whether such agreements should be necessary is questionable. See Joshua Stein, *Needless Disturbances? Do Nondisturbance Agreements Justify All the Time and Trouble?*, 37 REAL PROP. PROB. & TR. J. 701, 732 (2003) (suggesting that there should be no need for an attornment agreement in the foreclosure context, because it is clear that a tenant must attorn to an outright purchaser of the landlord’s interest whether the lease contains an attornment clause or not).

those jurisdictions. In effect, a state following that approach and requiring notice to junior tenants says to the foreclosing creditor, “You must send notice to the junior lessors and therefore terminate their leases, whether you want to do so or not. If you don’t, we’ll make you do it again until you get it right.”

As we have already noted, states that do not require notice to junior parties create similar problems for creditors seeking to preserve specific junior leases. In those states, there is simply no way for a foreclosing creditor to omit a junior lease in order to preserve it, because no notice need be sent to junior parties in any event. Even in states like California, which requires notice to recorded junior tenants,²⁹⁰ omitting notice to a tenant may not have the desired effect of preserving the lease. This is illustrated by the decision of the California Court of Appeal in *Dover Mobile Estates v. Fiber Form Products, Inc.*²⁹¹ In *Dover*, the lease, by virtue of a subordination agreement, was junior to the deed of trust. The purchaser at the foreclosure sale regarded the lease as desirable and wanted to preserve it, but the court held that it was terminated automatically by the foreclosure. Indeed, the court seemed to say that termination is *always* the result in a California nonjudicial foreclosure, and that it is impossible for a creditor to foreclose without terminating all junior leases.²⁹² There is nothing in the California statute to contradict this result, which is inefficient and represents an undesirable policy.

C. UNFA’s Flexible Approach

As UNFA illustrates, the inflexibility of the Nevada, Minnesota, Missouri, and California nonjudicial foreclosure statutes is entirely unnecessary. Under UNFA, the recording of the foreclosure deed transfers title subject to “interests of persons entitled to notice of

290. CAL. CIV. CODE § 2924b(c)(2) (West Supp. 2004).

291. 270 Cal. Rptr. 183 (Ct. App. 1990).

292. “A lease which is subordinate to the deed of trust is extinguished by the foreclosure sale. A foreclosure proceeding destroys a lease junior to the deed of trust, as well as the lessee’s rights and obligations under the lease.” *Id.* at 186 (citations omitted). Missouri and Texas apparently agree, although in neither state is the relevant case particularly clear. *See Kage v. 1795 Dunn Rd., Inc.*, 428 S.W.2d 735, 737 (Mo. 1968) (“[F]oreclosure of leased premises, under a mortgage antedating the lease, nullifies and extinguishes the lease” (quoting *Roosevelt Hotel Corp. v. Williams*, 56 S.W.2d 801, 802 (Mo. Ct. App. 1933))); *Peck & Hills Furniture Co. v. Long*, 68 S.W.2d 288, 289 (Tex. Civ. App. 1934) (“The sale under foreclosure gave the right to the purchaser to either terminate the lease or to continue it in force *with the tenants’ consent.*” (emphasis added)).

foreclosure . . . that were not given notice of foreclosure.”²⁹³ Because junior lessees are generally entitled to notice under UNFA,²⁹⁴ all a foreclosing creditor need do to omit a junior lessee intentionally and preserve the junior lease is to refrain from sending notice of foreclosure to the lessee. Because the affidavit that must be recorded coincident with the foreclosure deed requires “identification of the persons to which [*sic*] notice of foreclosure was given and the recording data for documents reflecting their interests in the collateral,”²⁹⁵ it is a simple matter for anyone checking the public records to determine whether a particular lease or other interest was omitted.

If a junior tenant is omitted, the tenant will remain bound under the lease even though the purchaser at the foreclosure sale will be substituted for the original landlord. No attornment agreement from the tenant is necessary to preserve the lease. From the tenant’s viewpoint, the situation is the same as if the landlord had simply assigned its rights or had sold the property subject to the lease. The tenant has no choice about whether to attorn; the duty arises automatically.

UNFA also recognizes that, even after instituting a foreclosure and giving notice of foreclosure to the full gamut of junior interest holders, the foreclosing creditor may reverse its position and decide to preserve an interest (typically a lease) whose holder has already been sent notice. Such a reversal of position might result from the creditor’s further investigation of the facts underlying the lease and the discovery that retaining it would be economically advantageous. This could probably be accomplished simply by sending a written revocation of the notice, for UNFA permits the revocation of any notice “unless the recipient materially changed its position in reliance on the notice before receiving the revocation.”²⁹⁶ This provision would probably accommodate such changes of position by a foreclosing creditor in many circumstances.

However, that approach might also become bogged down in litigation about the materiality of a tenant’s change of position. To

293. UNFA art. 6, § 603(2).

294. With one exception: unrecorded junior lessees are not entitled to notice unless the foreclosing creditor has actual knowledge of them. UNFA provides an alternate method for the creditor to preserve unrecorded junior leases, as described *infra* notes 297–99 and accompanying text.

295. UNFA art. 6, § 602(a)(2)(E).

296. UNFA art. 1, § 111.

avoid that situation, UNFA also provides that the foreclosing creditor can give any junior interest holder a “notice of preservation” that will preserve its interest from termination by the foreclosure even if a notice of foreclosure has already been sent.²⁹⁷ There are, however, two restrictions on the use of the “notice of preservation.” The first restriction is that a notice of preservation ordinarily must be sent at least thirty days prior to foreclosure,²⁹⁸ a provision intended to give the junior party reasonable notice about its status when the foreclosure is completed. The other restriction is that, having once given a notice of preservation, the creditor cannot thereafter revoke it. This provision prevents the creditor from manipulating the junior party with a series of contradictory and confusing notices. If a notice of preservation is given, this fact must be stated in the affidavit that is recorded with the foreclosure deed²⁹⁹ so that parties who acquire interests in the property later will be able to determine the status of the leases. Through these provisions, UNFA gives foreclosing creditors great latitude in deciding whether to terminate or preserve junior leases, while at the same time ensuring that junior lessees are fairly informed of their standing.

D. Unrecorded Leases

The discussion above assumes that junior leases are recorded, so that the foreclosing creditor can discover them by a title examination. In most jurisdictions, however, leases that do not exceed some stated term—typically one, two, or three years—are not within the scope of the recording acts.³⁰⁰ Moreover, as a practical matter, it is common to have unrecorded leases of much longer terms. The question arises whether the foreclosing creditor is bound by the doctrine of “constructive notice” from possession by an unrecorded lessee. In other words, if a tenant is in possession, does that possession give the creditor sufficient notice so that the creditor, to terminate the lease, must give notice of foreclosure to the tenant?

297. UNFA art. 2, § 210.

298. A later notice of preservation is permitted if, in a foreclosure by negotiated sale or by appraisal, the foreclosing creditor receives a notice of objection to the sale from the holder of a subordinate interest and wishes to preserve that interest to obviate the objection. UNFA art. 4, § 404(a)(2); art. 5, § 504(a)(2).

299. UNFA art. 6, § 602(a)(2)(G).

300. *See, e.g.*, N.C. GEN. STAT. § 47-18(a) (2003) (addressing leases not exceeding three years); WASH. REV. CODE ANN. § 65.08.060(3) (West Supp. 2004) (addressing leases not exceeding two years).

UNFA rejects the notion that a tenant is entitled to notice based solely on the tenant's possession. Such an entitlement would be problematic from a practical perspective, because it can be very difficult for an observer to detect whether persons in possession of real estate are agents or employees of the owner or of a tenant. Consider the case of a commercial warehouse, some portion of which has been leased by its owner to a tenant. There are loading docks, forklifts, and containers being moved about by various personnel. Even if a foreclosing creditor visits the site and observes this activity, the creditor has no information from which to discover that a lease exists and that some part of the activity is being carried out by the tenant's personnel. Such a discovery depends on the creditor's fortuitously asking the right questions to the right people. Analogous situations arise in office or retail store settings. In the view of UNFA's drafters, discerning whether a tenant is in possession is a burden that cannot reasonably be imposed upon foreclosing lenders.

This policy decision manifests itself in the language of UNFA. The Act provides that if foreclosing creditors know of a junior interest and wish to terminate it, they have an obligation to notify the interest holder of the foreclosure.³⁰¹ Ordinarily, the doctrine of constructive knowledge³⁰² would apply under UNFA, because the Act imputes knowledge of a fact if, "from all of the facts and circumstances known to the person at the time in question, the person has reason to know the fact exists."³⁰³ But UNFA adopts a special rule with regard to knowledge gained from visiting or viewing the property: "If a foreclosing creditor would have reason to know a fact only through an inspection of the collateral, knowledge of the fact is imputed to the creditor only to the extent that the creditor has made

301. UNFA art. 2, § 203(c)(4).

302. The doctrine is usually termed "constructive notice." *See, e.g.*, *Citgo Petroleum Corp. v. Fla. E. Coast Ry. Co.*, 706 So. 2d 383, 385–86 (Fla. Dist. Ct. App. 1998) (finding that the construction and operation of a pipeline gave the property's purchaser constructive notice of the pipeline easement); *Gordon v. Madison*, 9 S.W.3d 476, 480 (Tex. Ct. App. 2000) (determining that the owner's possession of property, residence there, and collection of rents gave the purchaser of the property constructive notice of the owner's rights); WILLIAM B. STOEUBUCK & DALE A. WHITMAN, *THE LAW OF PROPERTY* 883–86 (3d ed. 2000) (discussing issues stemming from constructive notice requirements). However, the drafters of UNFA were concerned about the potential for confusion between "notice" as meaning the imputation of knowledge and "notice" as referring to a document providing information to a recipient. To avoid the confusion, they used the term "knowledge" rather than "notice" in the imputation context. UNFA art. 1, § 112.

303. UNFA art. 1, § 112(a)(3).

an inspection.”³⁰⁴ Hence, UNFA does not expect creditors to visit or inspect the real estate before foreclosing. The creditor is held to have knowledge of a lease or other subordinate interest from a party’s possession only if the creditor *in fact* makes an inspection and actually discovers facts indicating the existence of that interest.³⁰⁵

UNFA’s treatment of unrecorded junior interest holders is consistent with some existing nonjudicial foreclosure statutes, but those statutes paint a mixed picture. As noted in Section A, about half of the statutes make no provision at all for notice to junior interest holders. Of the statutes that do require notice to juniors, many provide for such notice to be given only to those whose interests are recorded.³⁰⁶ Some require notice, not only to junior interest holders of record, but also to those of whom the creditor has actual knowledge.³⁰⁷ A few also require notice to parties in possession,

304. *Id.* § 112(b).

305. Of course, the creditor may have knowledge of the junior lease from other information sources, such as correspondence received from the borrower or the junior tenant. If the creditor has such knowledge, it must give the tenant notice for the foreclosure to terminate the lease.

306. *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-809B(2) (West Supp. 2003) (mandating notice “to each person who . . . appears on the records of the county recorder . . . to have an interest in any of the trust property”); CAL. CIV. CODE § 2924b(c)(2) (West Supp. 2004) (requiring that notice be given to “[t]he beneficiary or mortgagee of any deed of trust or mortgage recorded subsequent to the deed of trust or mortgage being foreclosed”); COLO. REV. STAT. § 38-38-101(7)(a) (2003) (requiring notice “to each person who appears to have acquired a record interest in the property described in such notice of sale subsequent to the recording of such deed of trust”); HAW. REV. STAT. ANN. § 667-22(c)(2) (Michie 2002) (mandating notice to “[a]ny prior or junior creditors having a recorded lien on the mortgaged property before the recordation of the notice of default”); OKLA. STAT. ANN. tit. 46, § 45(A) (West 1996) (directing notice to “any holder of a prior mortgage or other lien of record, and any person having an interest, claim or lien of record in the property”).

307. *See, e.g.*, ALASKA STAT. § 34.20.070(c) (Michie 2002) (requiring notice “where the lien or interest appears of record or where the trustee or the beneficiary has actual notice of the lien or interest”); ARK. CODE ANN. § 18-50-104(b)(3) (Michie 2003) (requiring notice to “[a]ny person having a lien or interest subsequent to the interest of the mortgagee or trustee when that lien or interest appears of record or when the mortgagee, the trustee, or the beneficiary has actual notice of the lien or interest”); IDAHO CODE § 45-1506(2) (Michie 2003) (requiring notice when “the beneficiary has actual notice”); OR. REV. STAT. § 86.740(1)(b) (2003) (requiring notice to the “successor in interest to the grantor whose interest appears of record, or of whose interest the trustee or the beneficiary has actual notice”). Virginia requires notice to

(i) the present owner of the property . . . (ii) any subordinate lienholder who holds a note against the property secured by a deed of trust recorded at least 30 days prior to the proposed sale . . . (iii) any assignee of such a note . . . (iv) any condominium unit owners’ association . . . (v) any property owners’ association . . . and (vi) any proprietary lessees’ association which has filed a lien. . . .

VA. CODE ANN. § 55-59.1(A) (Michie Supp. 2004).

whether or not recorded or within the creditor's actual knowledge.³⁰⁸ New York provides for notice to those of whom the foreclosing creditor has "constructive notice,"³⁰⁹ but offers no explanation of that term's meaning. Still other states provide for notice to juniors but leave the reader to speculate about what steps are necessary to identify the juniors.³¹⁰ Overall, it is hard to avoid the conclusion that the treatment of unrecorded leases was not a subject to which the drafters of the existing foreclosure statutes gave serious thought.

UNFA's position is a reasonable compromise in light of the difficulties faced by creditors in sending notice to persons in possession whose interests are unrecorded. Well-advised tenants who are concerned about getting foreclosure notices can eliminate the problem by recording their leases or memoranda of their leases. UNFA's requirement that the foreclosing creditor post a conspicuous sign on the property stating that foreclosure has commenced and identifying the creditor also mitigates concern that persons in possession may fail to discover the foreclosure.³¹¹

Assuming that foreclosing creditors do not make preforeclosure inspections that reveal the presence of unrecorded junior leases, that they have no other knowledge of such leases, and that they therefore send no notice of foreclosure to tenants, how do foreclosures affect the leases? Such leases are terminated by foreclosure even absent notice to the tenants in question. UNFA provides that title passes in

308. See, e.g., IOWA CODE ANN. § 655A.3(2) (West Supp. 2004) (requiring that notice be served "on the person in possession of the real estate, if different than the mortgagor, and on all junior lienholders of record"); MINN. STAT. § 580.03 (West 2000) (requiring notice "upon the person in possession of the mortgaged premises, if the same are actually occupied"); WASH. REV. CODE ANN. § 61.24.040(1)(b)(vi) (West 2004) (mandating notice to persons with recorded interests and "occupants of property consisting solely of a single-family residence, or a condominium, cooperative, or other dwelling unit in a multiplex or other building containing fewer than five residential units, whether or not the occupant's rental agreement is recorded").

309. See N.Y. REAL PROP. ACTS. LAW § 1402(1) (McKinney Supp. 2004) (repealed effective July 1, 2005), requiring notice

to any person or entity having a lien of record upon the mortgaged property, or interest in the mortgaged property subordinate to the mortgage that the mortgagee seeks to foreclose, at the time of the filing of the notice of pendency of which the mortgagee has actual knowledge or is on constructive notice.

310. See, e.g., MD. CODE ANN., REAL PROP. § 7-105(c)(2) (2003) (requiring notice "to the holder of any subordinate mortgage, deed of trust, or other subordinate interest"); S.D. CODIFIED LAWS § 21-48-6.1 (Michie Supp. 2003) (requiring service of notice "on the mortgagor and any lien holder or encumbrancer whose interest in the property being foreclosed would be affected by the foreclosure").

311. UNFA art. 2, § 203(e). The sign must be posted within ten days of recording the notice of foreclosure. *Id.*

foreclosure subject to “interests of persons entitled to notice of foreclosure . . . that were not given notice of foreclosure.”³¹² Because a tenant whose lease is unrecorded and unknown to the creditor has no entitlement to notice, the title passing out of foreclosure is *not* subject to the tenant’s lease, and the lease is cut off. This rule effectively imposes upon all tenants wishing to assure themselves notice of future foreclosures the obligation to record their leases, to record requests for notice,³¹³ or in some other way to notify senior lenders of their leases.

Suppose a foreclosing creditor wishes to preserve an unrecorded subordinate lease which would otherwise be terminated automatically by the provisions just discussed. Here again the “notice of preservation” authorized by UNFA can come into play.³¹⁴ The creditor can reverse the usual result—termination of the lease—simply by sending the tenant a notice of preservation up to thirty days before foreclosure. Of course, a creditor cannot send a notice to a tenant of whom the creditor is unaware. Hence, a creditor suspecting that there may be unrecorded leases worth preserving has an incentive to investigate the possible presence of such leases promptly.

V. POSTFORECLOSURE MEASURES

In this Part we focus on how UNFA deals with a variety of postforeclosure issues that can undermine the efficiency and predictability of the foreclosure process. First, we deal with UNFA’s treatment of a foreclosure surplus—the amount by which the foreclosure proceeds exceed the mortgage obligation and costs of sale.³¹⁵ Often competing claims to a surplus by the foreclosed mortgagor and other junior interests can result in protracted litigation. UNFA’s solution to these surplus disputes, however, may itself be problematic and, consequently, is the subject of substantial scrutiny in this Part. Next, we explore UNFA’s handling of deficiency judgments and its special treatment of residential debtors.³¹⁶ Our focus is on the extent to which adoption of UNFA would impact current state deficiency regulation. Third, we explore how UNFA deals with one of the thorniest power of sale dilemmas—the fact that

312. UNFA art. 6, § 603(2).

313. UNFA art. 2, § 205.

314. *Id.* § 210.

315. *See infra* Part V.A.

316. *See infra* Part V.B.

power of sale foreclosure titles have traditionally been considered more error-prone than those produced by judicial foreclosure. In this context, we examine how UNFA's "presumption" section deals with title stability.³¹⁷ Finally, we consider a very practical and sometimes troubling postforeclosure question—how a foreclosure purchaser obtains possession if the former owner refuses to leave the premises.³¹⁸ The UNFA approach to this issue is twofold. First, it properly eschews the use of "self-help" by the purchaser. Second, it makes it clear that the purchaser may obtain possession by invoking the summary proceedings commonly used in the landlord-tenant context. We conclude that this summary remedy is not the proper forum for foreclosed parties to challenge the validity of the purchaser's foreclosure title.

A. *The Disposition of Foreclosure Surplus*

Sometimes a foreclosure sale yields a surplus amount in excess of what is needed to satisfy the mortgage obligation and the expenses of sale. In essence, when a surplus results, it represents what remains of the debtor's ownership or "equity of redemption" and is conceptually a substitute res.³¹⁹ As such, the surplus stands in the place of the foreclosed real estate. The liens and other interests that previously attached to that real estate attach to the surplus in the order of priority that they enjoyed prior to the foreclosure.³²⁰ Even when statutes or mortgage language purport to give the surplus to the holder of the equity of redemption or the holder's "legal representative or assigns" and make no mention of junior interests, courts interpret such statutes to give junior interests rights to the surplus and priority over the holder of the equity of redemption.³²¹

317. See *infra* Part V.C.

318. See *infra* Part V.D.

319. NELSON & WHITMAN, *supra* note 17, at 643.

320. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.4 (1997) ("[T]he surplus is applied to liens and other interests terminated by the foreclosure in order of their priority and the remaining balance, if any, is distributed to the holder of the equity of redemption."); NELSON & WHITMAN, *supra* note 17, at 643–47 (describing generally the rules of surplus).

321. NELSON & WHITMAN, *supra* note 17, at 643–47; see, e.g., IND. CODE ANN. § 32-30-10-14 (Michie 2002) (directing payment "to the mortgage debtor, mortgage debtor's heirs, or other persons assigned by the mortgage debtor"); MINN. STAT. ANN. § 580.10 (West 2000) (mandating that the surplus be paid to "the mortgagor, the mortgagor's legal representatives or assigns"); WASH. REV. CODE ANN. § 61.12.150 (West 2004) (directing that "the surplus shall be paid to the mortgage debtor, his heirs and assigns"); *Cruse v. Roberts* (*In re Roberts*), 91 B.R. 57, 59–60 (Bankr. E.D. Mo. 1988) (finding that the language in a senior deed of trust purporting to give

Thus, the claim of the foreclosed holder of the equity of redemption is junior to all liens and other interests destroyed by the foreclosure. These “other interests” are not limited to liens. “[Junior easement holders and lessees] are entitled to receive, in order of their pre-foreclosure priority, the fair market value of their interests as of the date of foreclosure.”³²² Fair market value is determined in the same manner as in eminent domain proceedings.³²³

UNFA, however, may exclude such nonlien interests. Section 604 of UNFA provides that, after paying the obligation being foreclosed and the costs of sale, the foreclosing creditor is directed to pay the remaining proceeds in the following order: “in the order of their priority, the amounts secured by *all liens* terminated by the foreclosure; and . . . to the person that owned the collateral at the time of foreclosure.”³²⁴ On its face this language could mean that the holders of nonlien junior interests, such as easements and leases, have no substantive claim to any surplus created by an UNFA foreclosure.

A more plausible interpretation, however, is that section 604’s primary purpose is to provide the foreclosing creditor with an efficient mechanism for disposing of the surplus and bringing the foreclosure process to a prompt termination. Under this view, section 604 is *procedural* in nature and not intended to alter established

the senior surplus to the mortgagor over the junior lienors did not deprive the junior lienors of priority to the surplus over the mortgagor); *Boedeker v. Jordan*, 79 B.R. 843, 843–44 (Bankr. E.D. Mo 1986) (same); *First Colonial Bank for Sav. v. Bergeron*, 646 N.E.2d 758, 760 (Mass. App. Ct. 1995) (“[The statute] requires a foreclosing mortgagee to pay any surplus proceeds to the ‘mortgagor, or his heirs, successors or assigns.’ The junior mortgagee, of course, is considered to be a successor or assignee of the mortgagor, and therefore is entitled to surplus proceeds under the statute.”); *Fuller v. Langum*, 33 N.W. 122, 122 (Minn. 1887) (finding a junior lienor an “assign” of the mortgagor); *Brown v. Crookston Agric. Assoc.*, 26 N.W. 907, 907–08 (Minn. 1886) (same).

Similarly, when the foregoing language is not statutory, but is contained in the mortgage itself, courts favor junior interest holders over the holder of the equity of redemption. NELSON & WHITMAN, *supra* note 17, at 644. Under the Restatement, even “where mortgage language directs that surplus be paid to the ‘mortgagor’ . . . foreclosed junior lienholders and other junior interests simply will be treated as ‘successors’ or ‘assigns’ of the mortgagor for surplus disposition purposes.” RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.4 cmt. d. Moreover, the Restatement continues to favor junior lienholders against the mortgagor even where the senior mortgage makes it crystal clear that “surplus shall be paid to the mortgagor and not to the holder of any lien or other interest subordinate to this mortgage.” *Id.* § 7.4 illus. 8.

322. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.4 cmt. d, illus. 3; *see also* *Anderman v. 1395 E. 52nd St. Realty Corp.*, 303 N.Y.S.2d 474, 476 (Sup. Ct. 1969) (affirming an easement holder’s valid claim to the surplus).

323. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.4 cmt. d, illus. 3.

324. UNFA art. 6, § 604(a) (emphasis added).

norms governing terminated parties' substantive rights to share in any surplus. Language in the UNFA commentary to section 604 buttresses this position. The only reason articulated in the commentary for excluding foreclosed easement holders and lessees is the difficulty of establishing the value (if any) of such interests.³²⁵ Thus efficiency, rather than hostility to the interests of foreclosed lessees and easement holders, seems the dominant theme of the section. The value of nonlien interests, unlike liens, is not liquidated, and the holders of nonlien interests can still protect their interests by other means. Therefore, omitting distribution to holders of such interests avoids the administrative inconvenience of determining their value.

Interpreting section 604 to omit nonlien interests would be fundamentally unfair to junior easement holders and lessees, and would radically upset fundamental property law norms. The notion that a surplus represents what is left of the foreclosed real estate and that foreclosed interests share in that substitute res in order of their priority is a fundamental maxim of mortgage law.³²⁶ One cannot easily assume that most legislatures adopting UNFA would contend that valuation difficulties alone justify awarding the surplus to the former equity of redemption holder as against the substantive claims of former lessees and easement holders. This conclusion finds further support in judicial decisions favoring foreclosed lienors and other junior interest holders over the former equity of redemption holder when courts are called upon to interpret statutory or mortgage language purporting to grant exclusive surplus rights to the latter party.³²⁷

There are other, more fundamental reasons to favor an interpretation of section 604 supporting surplus rights of nonlien, junior interests. Consider, for example, the plight of a foreclosed commercial lessee who had a substantial bonus value (the fair market value of the lessee's remaining interest in the lease exceeded the lessee's rental obligation) in a terminated lease. Every lease contains an express or implied covenant of quiet enjoyment that prohibits a

325. *Id.* § 604 cmt. The fact that section 604 is aimed primarily at making the foreclosure process efficient for the foreclosing lender is also manifest in its language protecting lenders from liability if they act "in good faith and without actual knowledge of the invalidity or lack of priority of the claim of a person to which [*sic*] distribution is made." *Id.* § 604(b).

326. *See supra* notes 319–21 and accompanying text.

327. *See supra* note 321 and accompanying text.

landlord from interfering with the lessee's possession.³²⁸ When a landlord-owner defaults on the mortgage obligation and allows foreclosure to terminate a junior lessee's possession, the covenant of quiet enjoyment is violated.³²⁹ To permit the former landlord-owner's claim to surplus to trump that of the foreclosed lessee rewards the former for violating his lease obligation, a result that hardly comports with public policy.

Similarly, it is fundamentally unfair to deprive foreclosed easement holders of their substantive right to a surplus. When foreclosure destroys an easement that includes the usual warranties, the grantor violates the covenants of warranty and quiet enjoyment, which are designed to compensate the grantee if the grantee is later evicted because of defective title to the easement.³³⁰ As in the junior lease context, permitting the former equity holder to acquire any of the surplus to the exclusion of the foreclosed easement holder would reward the former for violating his contractual obligation—surely an undesirable outcome.

Foreclosed lessees and easement holders also can assert other policy arguments to trump the former equity holder's claim to surplus. For example, it is a fundamental norm of mortgage law that “[a] holder of the equity of the redemption who purchases real estate at a foreclosure sale . . . acquires title subject to any lien or other interest that was junior to the foreclosed lien.”³³¹ Thus, the mortgagor cannot use the foreclosure to “cleanse” the title of the previously created interests. Of course, if the equity holder is personally liable on a junior lien or the junior interest contains the usual warranties of title, it would be inequitable to enable the mortgagor to benefit by violating those obligations. But even if the debt is nonrecourse and title warranties are nonexistent, there are still sound policy reasons for keeping those interests alive against the equity holder who is a foreclosure purchaser:

Even where the mortgage obligation is completely “non-recourse,” the mortgagor agrees to the satisfaction of that obligation out of the

328. See STOEUBUCK & WHITMAN, *supra* note 302, at 281–84 (discussing the common law right of quiet enjoyment).

329. *Id.* at 281; GRANT S. NELSON, WILLIAM B. STOEUBUCK, & DALE A. WHITMAN, *CONTEMPORARY PROPERTY* 420 (2002) (“[T]he covenant promises the tenant . . . that no third person *who has a better right of possession than the tenant* will disturb the tenant's possession.”).

330. NELSON & WHITMAN, *supra* note 55, at 680.

331. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 4.9(a) (1997).

mortgaged real estate. Thus, actions by the mortgagor that undermine the ability of the mortgagee to realize on the benefits of that agreement should be discouraged. Strong policy considerations also compel the application of the same rule to transferees of the mortgagor who take subject to the mortgage, but who do not assume liability on existing liens. In this type of transaction, the purchase price paid by the transferee is almost always reduced by the value of any liens that the transferee agrees are to remain on the real estate. To permit the transferee under such circumstances to acquire title through a senior lien foreclosure and, in so doing, to destroy junior liens, would enable the transferee to acquire the real estate for less than originally contemplated. Such unjust enrichment of the transferee should be discouraged.³³²

Even if equity holders do not act affirmatively to purchase at a foreclosure sale, the same considerations mitigate against taking any of the surplus so long as other junior interests are not fully satisfied. Whether the junior interest is a lienor, a lessee, or an easement holder, the equity holder, in creating those interests, agrees that they should be satisfied out of the mortgaged real estate. Moreover, when the equity holder is a transferee, the purchase price of the real estate is typically reduced to reflect the extent to which such encumbrances reduce its value. To allow that transferee to benefit from the surplus at the expense of those junior interests results in unjust enrichment.

Assuming that section 604 is intended simply to be an efficient procedural mechanism for the foreclosing lender and not to alter traditional norms governing the rights of foreclosed parties in surplus, how should foreclosed lessees and easement holders proceed to protect their interests? One possible remedy for holders of junior interests is to file suit to enjoin the distribution of the surplus to the former equity holder. In the context of such a suit, the lessee or easement holder could make a substantive claim to priority in the surplus as against the former equity holder. The problem with this approach is that it interferes with the efficiency objective of section 604—to allow the foreclosing creditor to liquidate the real estate without being entangled in protracted litigation. Thus, it is unlikely that courts will entertain actions for injunctive relief instigated by the holders of foreclosed junior interests.

A foreclosed lessee or easement holder is more likely to succeed in filing suit against a former equity holder after the latter has

332. *Id.* § 4.9 cmt. b.

received surplus funds from the foreclosing lender. In filing such an action, the interest holder would attach the surplus funds received by the former equity holder. The suit would not interfere with the foreclosure process and thus should be permitted to proceed. The problem, of course, is that if, as is likely, the former equity holder were also beset by the claims of other creditors, the former junior interests could wind up recovering little, if anything, from those surplus funds. Once the surplus is paid out and commingled with the former equity holder's other assets, there would no longer be a res or remainder of the mortgaged real estate to which a lien could attach.

An alternative approach, however, could prevent the commingling of the surplus. The former junior interest holder, after filing suit, could seek a writ of garnishment against the former equity holder. The effect of such a writ would be to intercept the funds coming to the former equity holder, ordering the foreclosing creditor to pay those funds into court to satisfy the junior interest holder's claim. Under this approach no commingling would occur. In addition, the foreclosing creditor would have no concern about the time and expense required to establish the value of the junior interest—that would be a matter for decision in a suit between the junior interest holder and the former equity holder. Thus the concern for administrative inconvenience to the foreclosing creditor would not be implicated. The garnishment should take priority over the claims of the general creditors of the former equity holder, because the foreclosure proceeds would not yet have been commingled with the former equity holder's other assets and the junior interest holder would have a special and unique claim to those proceeds under the substitute res theory described above.

Section 604, even if interpreted most favorably to junior lessees and easement holders, is still substantially and unjustifiably prejudicial to those parties, forcing them to file lawsuits to get what is theirs. In our judgment, it would be preferable to amend section 604 prior to its adoption by any jurisdiction to clarify that surplus should be paid to all junior interests in order of their preforeclosure priority. After all, in the rare instances in which valuation questions arise and the junior interests fail to act in their self-interest to resolve the dispute among themselves, the foreclosing lender can resort to interpleader, a remedy that section 604 already makes available.

B. *Deficiency Judgments and Personal Liability*

In many cases, however, the foreclosure sale does not result in any surplus. Instead, the proceeds fall short of satisfying the foreclosed obligation, and the question arises as to whether the foreclosing creditor can recover a judgment against the mortgagor's other assets to cover the deficiency. UNFA is generally friendly to creditors seeking such deficiency judgments. First, UNFA does not mandate a "one-action" or "security-first" rule, which, as we described in Part I.A,³³³ requires a creditor to foreclose on the mortgaged real estate before bringing any personal action against the debtor on the mortgage obligation.³³⁴ Second, a creditor who forecloses under UNFA may, in general, obtain a deficiency judgment against any person who is personally liable on the mortgage obligation.³³⁵

1. *The Safe Harbor for Residential Debtors.* Only residential debtors are protected from this "prodeficiency judgment" rule. Residential debtors are not subject to deficiency judgments unless a court finds that they did not act in good faith and that their conduct "caused significant loss or damage to the foreclosing creditor or the collateral."³³⁶ According to the UNFA commentary,

Lenders generally believe that the threat of a deficiency judgment, even if it will rarely be enforceable as a practical matter, provides a useful inducement to borrowers to behave responsibly. The Act adopts that principle; under the "good faith" concept here, the risk of deficiency liability may dissuade a residential debtor from committing waste or fraud, or engaging in other acts detrimental to the foreclosing creditor's interests.³³⁷

On the other hand, a court will only infrequently find an absence of good faith. Not only does a creditor seeking a deficiency judgment have the burden of establishing an absence of good faith, but UNFA

333. *See supra* note 29 and accompanying text.

334. UNFA art. 1, § 103 cmt.

335. UNFA art. 6, § 607(a). UNFA imposes no limitations period for deficiency actions against debtors other than residential debtors. Such actions are governed by the adopting state's general statutes of limitation. *Id.* § 607 cmt. In states permitting deficiency actions against residential debtors, an action must be commenced within ninety days of foreclosure. *Id.* § 607(f).

336. *Id.* § 607(b)(2).

337. *Id.* § 607 cmt.

also affords a safe harbor against deficiency liability to a residential debtor who:

- (1) peaceably vacated the real property collateral and relinquished any personal property collateral within 21 days after the time of foreclosure and the receipt of a notice demanding possession by the person entitled to possession by virtue of the foreclosure;
- (2) did not engage in activity, unauthorized by the foreclosing creditor, that significantly reduced the value of the collateral as of the time possession was relinquished . . . ;
- (3) did not commit fraud against the foreclosing creditor;
- (4) did not permit significant uncured damage to the collateral by other persons or natural causes as a consequence of the debtor's failure to take reasonable precautions against such damage; and
- (5) provided reasonable access to the collateral for inspection by the foreclosing creditor and prospective purchasers.³³⁸

Moreover, because the foregoing rules represent only a safe harbor, a finding of good faith is possible even if there were minor violations of the rules, at least if the violations did not cause significant damage to the creditor's security interest.³³⁹

Unfortunately, this feature of UNFA may also protect a residential debtor who, for perfectly rational reasons, chooses default and foreclosure as an escape from what has developed into an unwise housing investment. Consider, for example, an upscale homeowner with substantial assets and income who owns a house in an area suffering from a weak economy and a substantial decline in real estate prices. These conditions existed, for example, in southern California in the early 1990s and in Texas during the mid-1980s. Suppose this homeowner paid \$800,000 for a house at the peak of the market. Three years later, the house is worth \$500,000 and the mortgage on it has a balance of \$590,000; the owner thus has "negative equity" in the property. Not wanting to "throw good money after bad," the owner, who has the financial ability to make further payments, chooses to default. So long as the owner complies with the five "safe harbor" elements delineated above, UNFA appears to treat

338. *Id.* § 607(c).

339. *Id.* § 607 cmt.

this defaulting debtor, who has the ability to pay, as being in “good faith” and therefore immune from a deficiency judgment. There is a persuasive argument that “choosing to default” when one has the ability to pay should be treated as strong evidence of “bad faith” even though the safe harbor elements are satisfied. An adopting jurisdiction might want to modify UNFA’s language to clarify that such strategic behavior can subject a residential debtor to deficiency liability.

2. *The “Fair Value” Limitation on Deficiencies.* When a deficiency judgment is permitted under UNFA, it is defined as the difference between the foreclosure amount (the sale price less the expenses of foreclosure) and the mortgage obligation.³⁴⁰ However, when the foreclosure is by auction sale (or, in the case of residential debtors, by any of the three types of foreclosure authorized by UNFA), a debtor may require that the deficiency judgment be subject to a “fair value” limitation.³⁴¹ As described in Part I.A, states utilizing this statutory approach measure a deficiency judgment as the difference between the foreclosure price and the fair market value of the property.³⁴² Two policy justifications are articulated for this limitation on deficiency judgments:

This approach enables the [foreclosing creditor] to be made whole where the mortgaged real estate is insufficient to satisfy the mortgage obligation, but at the same time protects against the [foreclosing creditor’s] purchasing the property at a deflated price, obtaining a deficiency judgment and, by reselling the real estate at a profit, achieving a recovery that exceeds the obligation. Thus, it is aimed primarily at preventing the unjust enrichment of the [foreclosing creditor]. [It] also protects the [debtor] from the harsh consequences of suffering both the loss of the real estate and the burden of a deficiency judgment that does not fairly recognize the value of that real estate.³⁴³

UNFA’s formulation utilizes a “90 percent of fair market value” approach. Thus, a debtor against whom such a judgment is sought “may offer proof that the foreclosure amount was less than 90 percent of the fair market value of the collateral as of the time of the

340. *Id.* § 608(a).

341. *Id.* § 608(b)(2).

342. *See supra* note 32 and accompanying text.

343. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4 cmt. a (1997).

auction.”³⁴⁴ The court, if convinced by the debtor’s proof, “shall substitute 90 percent of the fair market value of the collateral for the foreclosure amount” in determining the amount of the deficiency.³⁴⁵ UNFA adopts this approach to “approximate the probable cost to the foreclosure purchaser of holding and liquidating the collateral, and to reflect the sense that it is usually unrealistic to expect foreclosure amounts significantly higher than 90% of fair value.”³⁴⁶ This fair market value limitation is available to debtors irrespective of whether the foreclosure purchaser is the foreclosing creditor or a third party.³⁴⁷

The following example helpfully illustrates the impact of a fair market value limitation. A mortgage with a current balance of \$200,000 (the only lien on the real estate) is foreclosed at a public auction sale. The successful bid price at the foreclosure sale is \$140,000. Valid expenses of sale are \$3,000. In the absence of a fair market value limitation, the proceeds of sale would be distributed as follows: First, \$3,000 would be used to pay the expenses of foreclosure. Next, the remaining amount, \$137,000, would be paid to the foreclosing creditor. The deficiency judgment would be \$63,000 (\$200,000 minus \$137,000).

Assume instead that the UNFA fair market value limitation is applicable. A court determines that the fair market value of the real estate at the time of foreclosure was \$175,000 and that 90 percent of the latter amount is \$157,000. Because the foreclosure amount (\$140,000) is less than \$157,000, the court treats \$157,000 as the foreclosure amount. The foreclosing mortgagee then distributes the funds as follows: \$3,000 would be allotted to pay the foreclosure expenses and \$154,000 would be credited to the amount owing on the foreclosed mortgage. The UNFA deficiency judgment would be

344. UNFA art. 6, § 608(b)(2).

345. *Id.* § 608(c).

346. *Id.* § 608 cmt. The Restatement endorses the “fair market value” concept for measuring deficiency judgments, but it does not use the 90 percent figure. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.4(d) (“If it is determined that the fair market value is greater than the foreclosure sale price, the persons against whom recovery of the deficiency is sought are entitled to an offset against the deficiency in the amount by which the fair market value . . . exceeds the sale price.”). However, the Restatement recognizes that “[w]here the mortgagee is the foreclosure purchaser, after the fair market value is determined, the court must deduct from that amount the mortgagee’s anticipated reasonable costs of resale. This amount will include a reasonable broker’s commission, seller’s title expenses and related costs.” *Id.* § 8.4 cmt. Hence, applying the Restatement will produce a result roughly similar to UNFA’s.

347. UNFA art. 6, § 608 cmt.

\$46,000 (\$200,000 minus \$154,000). As this example shows, UNFA's fair value rule can result in a significantly reduced deficiency liability.

3. *Fitting UNFA into Existing State Law.* We turn now to consideration of the extent to which adoption of UNFA would change current state law governing deficiency judgments and debtor personal liability. Generalizations are difficult, however, because this area of mortgage law not only lacks national uniformity, but, in a few jurisdictions, can be fiendishly labyrinthine in its complexity.³⁴⁸ At one doctrinal pole are states that currently follow the traditional, common law approach to deficiency judgments and personal liability.³⁴⁹ In these jurisdictions, unless the mortgage obligation is by its terms nonrecourse, a mortgagee

may first obtain a judgment on the personal obligation and later foreclose on the mortgaged real estate for any part of the judgment that is not satisfied from [the] mortgagor's other property. Alternatively, it may . . . foreclose against the mortgaged real estate and if the sale proceeds are insufficient to satisfy the mortgage obligation, it may then obtain a deficiency judgment for the balance."³⁵⁰

Whether the foreclosure proceeding is judicial or by power of sale, a deficiency judgment is normally measured by the extent to which the mortgage obligation exceeds the foreclosure sale price.³⁵¹ In those common law states, UNFA's impact would be relatively predictable and straightforward.

UNFA's adoption would have a significant impact only in the context of nonjudicial foreclosure. If a foreclosing creditor chooses to foreclose under UNFA against a residential debtor who is in good faith, no deficiency judgment is allowed. If the UNFA foreclosure is against some other debtor, a deficiency judgment is available, but the debtor has the right to have it measured by the "90 percent of fair

348. Consider, for example, the description of the California antideficiency legislation: "Perhaps more than any jurisdiction, California has a complex and pervasive anti-deficiency legislative scheme. It not only frequently creates bewilderment among lawyers from other jurisdictions, it often proves perplexing for California practitioners as well." NELSON & WHITMAN, *supra* note 17, at 667.

349. See *supra* notes 26–28 and accompanying text.

350. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.2 cmt. a.

351. NELSON & WHITMAN, *supra* note 17, at 653.

market value” limitation. Note, however, that UNFA does not purport to change a debtor’s personal liability status; it does not transform a recourse obligation to nonrecourse status. This is the case even with respect to a residential debtor. Thus, for example, if mortgaged real estate is worth only a small portion of the mortgage obligation, but the residential debtor has a substantial net worth, the creditor may choose to pursue judicial foreclosure rather than foreclosure under UNFA, and to seek a traditional deficiency judgment in the context of the judicial proceeding. In this scenario, the “90 percent of fair market value” limitation would be inapplicable. Alternatively, the creditor could simply sue on the note, attempt to collect the judgment out of the debtor’s other assets and, if those were insufficient, foreclose on the mortgaged real estate either judicially or nonjudicially for the balance of the obligation still owing. Of course, if the creditor’s last collection step were nonjudicial foreclosure under UNFA, the fair market value limitation would be applicable to determine the extent to which the mortgaged real estate could be used to satisfy the remainder of the mortgage obligation.

At the other doctrinal extreme is California, which has adopted virtually every deficiency and personal liability restriction known to humankind. California’s “one-action” and “security-first” principles require that lenders foreclose on the real estate before seeking a deficiency judgment.³⁵² Moreover, a California lender may not obtain a deficiency judgment after a power of sale foreclosure.³⁵³ Most importantly, California has a broad prohibition on deficiency judgments for purchase money mortgages. Under section 580b of the California Code of Civil Procedure this prohibition extends to all vendors who take back real estate security and to third-party lenders who take a mortgage to secure all or part of the purchase price for purchaser-occupied dwellings accommodating fewer than five families.³⁵⁴ Not only are deficiency judgments barred in the foregoing

352. See CAL. CIV. PROC. CODE § 726(a) (West Supp. 2004) (“There can be but one form of action for the recovery of any debt or the enforcement of any right secured by mortgage upon real property or an estate for years therein . . .”).

353. See CAL. CIV. PROC. CODE § 580(d) (West Supp. 2004) (“No judgment shall be rendered for any deficiency . . . in which the real property or estate for years therein has been sold by the mortgage or trustee under power of sale . . .”).

354. CAL. CIV. PROC. CODE § 580(b) (West Supp. 2004) provides:

No deficiency judgment shall lie in any event after a sale of real property . . . under a deed of trust or mortgage given to the vendor to secure payment of the balance of the purchase price of that real property . . . or under a deed of trust, or mortgage, on a dwelling for not more than four families given to a lender to secure repayment of a

purchase money situations, but California's statute has been judicially interpreted to bar personal liability in purchase money situations as well.³⁵⁵ For example, even a home seller who takes back a second mortgage or deed of trust and suffers its destruction by a senior lien foreclosure may not recover on the underlying obligation.³⁵⁶ As a result, there are relatively few situations in which a California lender can obtain either a deficiency judgment or a personal judgment on a mortgage obligation. Only when the loan is by a third-party lender on commercial real estate or on residential property containing five or more dwelling units may a deficiency judgment be obtained.³⁵⁷ Even then, the foreclosure must be by judicial action.³⁵⁸ Finally, in the rare instances in which a deficiency judgment is available, it is limited by "fair market value" legislation.³⁵⁹

California's adoption of UNFA's deficiency provisions would mark a radical departure from its existing antideficiency structure. First, although UNFA generally permits deficiency judgments after nonjudicial foreclosure,³⁶⁰ California does not. Second, whereas California bars both personal liability and deficiency judgments in a wide variety of purchase money mortgage contexts, UNFA prohibits deficiency liability only after nonjudicial foreclosure against residential debtors.³⁶¹ Under UNFA, a lender may still recover a

loan which was in fact used to pay all or part of the purchase price of that dwelling occupied, entirely or in part, by the purchaser.

355. See *Brown v. Jensen*, 259 P.2d 425, 426–27 (Cal. 1953) (holding that no action may be brought on a purchase money note even though the deed of trust securing it was destroyed by the foreclosure of a senior deed of trust); NELSON & WHITMAN, *supra* note 17, at 673–74 ("In *Brown v. Jensen*, the California Supreme Court held that section 580(b) barred a junior purchaser money lender, the vendor, from recovering a personal judgment from the vendee-borrower even though his security had been lost through foreclosure by the senior purchase money deed of trust.").

356. Ironically, the non-purchase money junior lienor whose lien is destroyed by a senior foreclosure is in a stronger position than the lienor's purchase money counterpart. See *Bank of Am. Nat'l Trust & Sav. Ass'n v. Graves*, 59 Cal. Rptr. 2d 288, 290–94 (Ct. App. 1996) (establishing that a foreclosed non-purchase money junior lienor holds security that is valueless and therefore may sue directly on the note).

357. See *supra* note 354.

358. See *supra* note 352.

359. See CAL. CIV. PROC. CODE § 580(a) (West Supp. 2004) ("The court may render judgment for not more than the amount by which the entire amount of the indebtedness due at the time of sale exceeded the fair market value of the real property."); CAL. CIV. PROC. CODE § 726(b) (West Supp. 2004) ("[T]he court shall render a money judgment against the defendant or defendants for the amount by which the amount of the indebtedness with interest and costs . . . exceeds the fair value of the real property.").

360. See *supra* notes 333–35 and accompanying text.

361. See *supra* notes 335–37 and accompanying text.

deficiency judgment against a residential debtor after a judicial foreclosure or may simply obtain a judgment on the mortgage obligation without resorting to foreclosure at all.³⁶² Unlike UNFA, however, California's legislation incorporates a broad "one-action" and "security-first" rule.³⁶³ Finally, UNFA's fair market value limitation, which applies only to nonjudicial foreclosure,³⁶⁴ does not exist in California.

California legislators, in considering UNFA, would be compelled to reevaluate the state's entire antideficiency regime. They would have to confront numerous policy questions. For example, should deficiency judgments continue to be barred after nonjudicial foreclosure? Should antideficiency protection be available only to residential debtors? Does it make sense to continue to protect a wide variety of commercial purchase money borrowers from both deficiency judgments and direct personal liability? Do the "one-action" and "security-first" principles continue to make sense? Why should a lender be required to proceed first against the real estate security when it is relying mainly on the personal credit of the borrower and the real estate may be an incidental factor in the loan transaction? Given the serious policy questions and complexities that UNFA would raise, it seems highly unlikely that California could or should adopt the Act's deficiency and personal liability approach without a thorough reexamination of its current antideficiency and personal liability structure.

Most states fall between the two doctrinal poles described above. These jurisdictions typically have adopted one or two of the common mechanisms for limiting deficiency judgments. For example, numerous states impose a "fair value" limitation on measuring deficiency judgments.³⁶⁵ For these states, the "90 percent of fair

362. See UNFA art. 1, § 103(e); *id.* § 103 cmt.

363. See *supra* note 352 and accompanying text.

364. See *supra* notes 344–47 and accompanying text.

365. See ARIZ. REV. STAT. ANN. § 33-814(A) (West 2000); COLO. REV. STAT. § 38-8-06(1) (2003); CONN. GEN. STAT. ANN. § 49-14 (West 1994); GA. CODE ANN. § 44-14-161(b) (2002); IDAHO CODE § 6-108 (Michie 2004); KAN. STAT. ANN. § 60-2415(b) (1994); ME. REV. STAT. ANN. tit. 14, § 6324 (West Supp. 2003); MICH. COMP. LAWS ANN. § 600.3280 (West 2000); MINN. STAT. ANN. § 582.30(5) (West Supp. 2004); NEB. REV. STAT. § 76-1013 (2004); NEV. REV. STAT. ANN. 40.457 (Michie 2002); N.J. STAT. ANN. § 2A:50-3 (2000); N.Y. REAL PROP. ACTS. LAW § 1371 (McKinney 1979); N.C. GEN. STAT. § 45-21.36 (2003); N.D. CENT. CODE § 32-19-06 (1996); OKLA. STAT. ANN. tit. 12, § 686 (West 2000); 42 PA. STAT. ANN. § 8103(a) (Supp. 2004); S.C. CODE ANN. § 29-3-700 (Law. Coop. Supp. 2004); S.D. CODIFIED LAWS § 21-47-16 (Michie Supp. 2003); TEX. PROP. CODE ANN. § 51.003(b) (Vernon 1995); UTAH CODE

market value” limitation that UNFA imposes on deficiency would not represent a substantial change from their current practice. For the handful of states that impose a “one-action” or “security-first” rule, UNFA poses a dilemma because it does not mandate such a limitation, and its structure assumes that lenders are free to proceed on the debtor’s personal obligation before or in lieu of foreclosing on the real estate.³⁶⁶ Several states bar deficiency judgments after any nonjudicial foreclosure.³⁶⁷ For these states, UNFA represents a significant change because it permits deficiency judgments after this type of foreclosure except in the case of residential debtors.

Finally, several states bar deficiency judgments in a variety of residential purchase money mortgage contexts.³⁶⁸ Courts in some of these states interpret their statutes, as discussed in the case of California above, as barring not only a deficiency judgment, but all borrower personal liability as well.³⁶⁹ In states where such interpretations prevail, the obligation is treated as nonrecourse. In such situations, the lender may neither (1) bring an action on the obligation, attempt to collect any ensuing judgment out of the debtor’s other assets and foreclose on the mortgaged real estate for the balance; nor (2) waive the security in its entirety and simply bring an action on the obligation. Were these states to adopt UNFA, deficiency judgments would be barred on loans to residential debtors

ANN. § 57-1-32 (Supp. 2004); WASH. REV. CODE ANN. § 61.12.060 (West 2004); WIS. STAT. ANN. § 846.165(2) (West 1994).

366. See *supra* notes 333–35 and accompanying text.

367. See ALASKA STAT. § 34.20.100 (Michie 2000); MINN. STAT. ANN. § 582.30(2)–(9); MONT. CODE ANN. § 71-1-317 (2003); WASH. REV. CODE ANN. § 61.24.100.

368. See ARIZ. REV. STAT. § 33-729(A) (2000); MONT. CODE ANN. § 71-1-232; N.C. GEN. STAT. § 45-21.38 (2003); OR. REV. STAT. § 88.070 (2003); S.D. CODIFIED LAWS § 44-8-20 to -25 (Michie 1997). These statutes have been criticized. See NELSON & WHITMAN, *supra* note 17, at 665:

To deny such vendor-mortgagee deficiency judgments in the event of a foreclosure may deter the use of socially useful financing. Moreover, it is also undesirable to deny a deficiency judgment to a third party purchase money mortgagee. Indeed, it is especially anomalous to penalize the person or institution who enabled the mortgagor to obtain the real estate in the first place.

369. See *Baker v. Gardner*, 770 P.2d 766, 772 (Ariz. 1988) (ruling that the holder of a purchase money note is not permitted to waive security and sue on the note); *Mid Kan. Fed. Sav. & Loan Ass’n v. Dynamic Dev. Corp.*, 804 P.2d 1310, 1313–17 (Ariz. 1991) (confirming the rule in *Baker*, but holding that the mortgagor-developer was not protected by the applicable statute); *Ross Realty Co. v. First Citizens Bank & Trust Co.*, 250 S.E.2d 271, 272–75 (N.C. 1979) (stating that when legislation barred deficiency judgments on vendor purchase money notes, the legislature also intended to bar personal liability on the notes); *Barnaby v. Boardman*, 330 S.E.2d 600, 601–04 (N.C. 1985) (maintaining that the holding in *Ross* applied even though the mortgaged real estate was commercial and the mortgagor was a “sophisticated” businessman).

irrespective of their purchase money character. In that sense, UNFA would afford broader protection to residential debtors than current state legislation. On the other hand, because UNFA does not confer nonrecourse status on such debtors, legislatures in these states would be forced to determine whether they wanted to give residential debtors simple antideficiency protection or broader immunity from personal liability.

C. Nonjudicial Foreclosure Titles: The Quest for Finality

Although power of sale foreclosure is clearly more efficient and less costly than judicial foreclosure, the titles it produces have traditionally been considered less stable than those produced by its judicial counterpart.³⁷⁰ There are several reasons for this outcome. First, court supervision of foreclosure prevents many defects. In the power of sale setting, the mortgagee or trustee normally controls the foreclosure process. Judicial foreclosure, on the other hand, entails judicial supervision both prior to and after the sale. Indeed, the mere presence of a judge probably deters many overt and intentional defects and otherwise encourages regularity in the foreclosure process.³⁷¹ Second and more importantly, because judicial foreclosure is an adversarial proceeding, the opposing parties aid the court in identifying potential defects—a restraint on the mortgagee absent in the power of sale context.³⁷² Finally, even if defects in the trial process go uncorrected, they will ultimately be obviated by the concept of judicial finality. If an aggrieved party fails to challenge the trial court's foreclosure decree within the time period for filing trial court motions or for appeal, there is little likelihood a subsequent collateral attack will succeed. Moreover, if there is a timely appeal and the foreclosure decree is upheld, finality is even more firmly established.³⁷³

370. See NELSON & WHITMAN, *supra* note 17, at 580, 584. Both of the authors, on different occasions, spoke at meetings of the Oklahoma Bar Association's Real Property Committee on the Oklahoma nonjudicial foreclosure statute, 1986 Okla. Sess. Laws 319 § 1 (codified at OKLA. STAT. tit. 46, § 43 (2004)), which was adopted in 1986. On both occasions, the lawyers present expressed significant concern as to the reliability of titles flowing from nonjudicial foreclosures.

371. NELSON & WHITMAN, *supra* note 17, at 584.

372. *Id.*

373. *Id.* Probably the only defect in the judicial foreclosure process that the rules of civil and appellate procedure do not inevitably cure is the failure to make the holder of a junior interest in the mortgaged real estate a party defendant. As a necessary party, an omitted junior interest holder is not bound by the foreclosure and can collaterally attack its application even after the

These principles of judicial finality are of little benefit to the power of sale foreclosure purchaser. Although time rapidly heals most wounds in the judicial foreclosure setting, title stability has proved more elusive in foreclosure by power of sale. The passage of time undoubtedly strengthens power of sale titles, but it does so largely by the invocation of such variable and less reliable mechanisms as statutes of limitation, adverse possession, laches, estoppel, and related notions.³⁷⁴

A unique terminology and system of classification have developed to analyze defective power of sale foreclosures. Typically, courts recognize three types of defects. Some defects are so substantial and prejudicial as to render the foreclosure sale *void*. In this situation, no title, legal or equitable, passes to the sale purchaser or the purchaser's subsequent grantees, except ultimately through adverse possession.³⁷⁵ Even if a bona fide purchaser purports to acquire title through the foreclosure, the court will set the sale aside and the bona fide purchaser will be deprived of title. Sales are typically void when, notwithstanding mortgagee compliance with the prescribed statutory procedure, the mortgagee lacked a substantive right to foreclose.³⁷⁶ Examples of such defects include a forged mortgage or a power of sale exercised when the underlying mortgage

time periods for direct review have expired. *Id.* at 572; *see also supra* notes 262–69 and accompanying text.

374. NELSON & WHITMAN, *supra* note 17, at 581.

375. *See, e.g.,* Gilroy v. Ryberg, 667 N.W.2d 544, 552–56 (Neb. 2003) (stating that when a defect renders a foreclosure void, no title, legal or equitable, is transferred to the purchaser); Henke v. First S. Props., Inc., 586 S.W.2d 617, 619 (Tex. Civ. App. 1979) (stating that if a defect renders a foreclosure sale void, title cannot pass to the purchaser); Deep v. Rose, 364 S.E.2d 228, 232 (Va. 1988) (noting that when a defect renders a sale void, “no title, legal or equitable, passes to the purchaser”); HERBERT T. TIFFANY, THE LAW OF REAL PROPERTY 637 (3d ed. 1939) (“The original purchaser at the sale under the power is charged with notice of any irregularities in the actual exercise of the power.”); Larry D. Dingus, *Mortgages—Redemption After Foreclosure Sale in Missouri*, 25 MO. L. REV. 261, 277 (1960) (“[W]hether a foreclosure sale will be set aside in a particular situation may depend upon whether a [sale] is held to be void or voidable.”).

376. *See* Rosenberg v. Smidt, 727 P.2d 778, 783–84 (Alaska 1986) (“[O]nly substantial defects such as the lack of a substantive basis to foreclose in the first place will make a sale void.”); Graham v. Oliver, 659 S.W.2d 601, 603 (Mo. Ct. App. 1983) (stating that when there is no underlying right to foreclose, the foreclosure is void); Gilroy, 667 N.W.2d at 554 (pointing out that defects rendering a sale void generally occur when the trustee conducts the sale without the right to exercise the power of sale). *But see* Bottomly v. Kabachnick, 434 N.E.2d 667, 669–70 (Mass. App. Ct. 1982) (holding the sale void despite default when the notice failed to identify the holder of the mortgage).

obligation was not in default.³⁷⁷ A sale is also void when the foreclosing party did not own the note³⁷⁸ or when a trustee under a deed of trust foreclosed without authorization from the noteholder.³⁷⁹ Moreover, failure to comply with certain fundamental procedural requirements may result in a void foreclosure. This can occur when a notice of sale omits a portion of the mortgaged real estate,³⁸⁰ or when there was a failure to send written notice to the mortgagor or another party as required by statute.³⁸¹ A sale under a deed of trust is also void if conducted by someone other than the named trustee³⁸² or by a

377. See, e.g., *Bradford v. Thompson*, 470 S.W.2d 633, 634–36 (Tex. 1971) (holding a foreclosure void when the second lien note was deemed not in default at the time of foreclosure); *Diversified, Inc. v. Walker*, 702 S.W.2d 717, 720–23 (Tex. Ct. App. 1985) (holding void a foreclosure sale that was conducted despite the mortgagor’s having tendered late installment payments pursuant to an agreement mortgagee); *TIFFANY*, *supra* note 375, at 637 (“The power of sale is ordinarily conditioned upon a failure to pay the debt at a time named, and consequently a sale before that time would, it seems, ordinarily be invalid for any purpose, even in favor of an innocent purchaser from the purchaser at the sale.”).

378. See *Williams v. Kimes*, 996 S.W.2d 43, 45 (Mo. 1999):

There are numerous circumstances that may render a foreclosure sale void: (1) where the foreclosing party does not hold title to the secured note; (2) where there has been no default by the mortgagor at or before the first publication of notice for the sale; (3) where the secured note has been paid; and (4) where the deed of trust authorizes sale upon request of its holder and no such request has been given.

See also *Cobe v. Lovan*, 92 S.W. 93, 96–98 (Mo. 1906) (concluding that a foreclosure is void when the person directing it does not hold the note); *Graham*, 659 S.W.2d at 603 (holding that when there is no underlying right to foreclose, the foreclosure is void).

379. See *Lustenberger v. Hutchinson*, 119 S.W.2d 921, 926–27 (Mo. 1938) (explaining that when the trust deed conditions foreclosure on the request of the holder of the note, foreclosure without such a request is void); *Graham*, 659 S.W.2d at 604 (holding that a sale should be voided “when the deed of trust authorizes sale upon the request of the holder of the secured note and there has been no such request”); see also *supra* notes 281–83 and accompanying text (listing states where foreclosure is void because of failure to adhere to statutory notice requirements).

380. See *Gilroy*, 667 N.W.2d at 554 (“[E]ven if there is a right to exercise the power of sale, an egregious failure to comply with fundamental procedural requirements while exercising the power of sale will render the sale void.”).

381. See *Little v. CFS Serv. Corp.*, 233 Cal. Rptr. 923, 924–27 (Ct. App. 1987) (stating that the failure to send notice of sale to the trustor and junior lienors rendered the sale void); *Williams*, 996 S.W.2d at 45–46 (opining that the failure to provide notice to the remaindermen rendered the sale void); *Shearer v. Allied Live Oak Bank*, 758 S.W.2d 940, 942 (Tex. App. 1988) (declaring that the failure to send notices as required by the deed of trust and statute rendered the sale void); see also *First Nat’l Bank Mansfield v. Nelson (In re Nelson)*, 134 B.R. 838, 847–48 (Bankr. N.D. Tex. 1991) (holding that giving notice by certified mail twenty-one days before the sale did not constitute notice of twenty-one days, rendering the sale void); *Deep v. Rose*, 364 S.E.2d 228, 232 (Va. 1988) (deeming void a sale held on the last day of advertisement, in violation of the statute).

382. See *Citizens Bank of Edina v. W. Quincy Auto Auction, Inc.*, 742 S.W.2d 161, 164 (Mo. 1987) (holding void a foreclosure sale conducted by the trustee’s son and law partner without the trustee’s presence or a provision authorizing a delegation of the trustee’s function).

successor who was not validly appointed.³⁸³ Conversely, a foreclosure is void if it is conducted by the original trustee after the appointment of a successor-trustee.³⁸⁴

Most defects, however, render a sale *voidable* rather than void. When this is the case, bare legal title passes to the sale purchaser, subject to the right of those injured by the defective foreclosure to have the sale set aside. Such defects, which are normally irregularities in the execution of a foreclosure sale, must be “substantial or result in a probable unfairness.”³⁸⁵ A common example of a voidable sale in many jurisdictions is a purchase by a trustee under a deed of trust at the trustee’s own sale.³⁸⁶ Additional examples include the publication of the notice of sale for slightly fewer than the statutorily prescribed number of times³⁸⁷ or the sale at the wrong door of the county courthouse.³⁸⁸

An inherent feature of a voidable sale (as opposed to one that is void) is that all rights to set aside the sale will be cut off if the land passes into the hands of a bona fide purchaser for value.³⁸⁹ When this

383. See *Winters v. Winters*, 820 S.W.2d 694, 695 (Mo. Ct. App. 1991) (holding the sale void when the successor trustee had not been validly appointed).

384. See *Dimock v. Emerald Props. LLC*, 97 Cal. Rptr. 2d 255, 262–63 (Ct. App. 2000) (declaring that the original trustee lacked authority to sell the property).

385. NELSON & WHITMAN, *supra* note 17, at 586. In a number of jurisdictions, the aggrieved party will be required to tender the balance due on the mortgage obligation as a condition precedent to attacking the sale. *Id.* at 605–10.

386. See, e.g., *Whitlow v. Mountain Trust Bank*, 207 S.E.2d 837, 840 (Va. 1974) (“Generally, a trustee cannot be both a seller and a buyer at his own auction sale.”); *Dingus*, *supra* note 375, at 276–77 (“If [a trustee in a deed of trust] does in fact become the purchaser, he takes the chance that in some circumstances the transfer may be set aside.”).

387. See, e.g., *Jackson Inv. Corp. v. Pittsfield Prods., Inc.*, 413 N.W.2d 99, 101 (Mich. Ct. App. 1987) (pronouncing that a defect in notice renders a sale voidable, not void); *Kenyon v. Camp*, 353 S.W.2d 693, 695 (Mo. 1962) (deeming a sale voidable when the trustee failed to advertise the sale for the prescribed period of thirty days).

388. See *Wakefield v. Dinger*, 135 S.W.2d 17, 21–23 (Mo. Ct. App. 1939) (holding that a sale at the west door of the courthouse—as opposed to the east door, as required by the deed of trust—was merely voidable, not void).

389. See Patricia J. Warren, Note, *Rosenberg v. Smidt: Dramatic Ramifications for Nonjudicial Foreclosure Sales in Alaska?*, 5 ALASKA L. REV. 357, 371 (1988) (“[A] foreclosure sale made to a bona fide purchaser will not be set aside by a court if it was merely voidable rather than void.”); see, e.g., *Rosenberg v. Smidt*, 727 P.2d 778, 784 (Alaska 1986) (“[W]here a defect in a foreclosure sale makes it merely voidable . . . sale to a bfp cuts off the trustor’s ability to set aside the sale.”); *Gilroy v. Ryberg*, 667 N.W.2d 544, 554 (Neb. 2003) (holding that when a defect renders a sale voidable, bare legal title passes to the purchaser and the sale may be set aside only if the legal title has not passed to a bona fide purchaser); *Steward v. Good*, 754 P.2d 150, 152 (Wash. Ct. App. 1988) (noting that sale to a bona fide purchaser results in a valid title notwithstanding procedural irregularities in the sale process). Either a foreclosure sale purchaser or a subsequent grantee may qualify as a bona fide purchaser.

occurs, the purchaser's title is immune from attack and an action for damages against the foreclosing mortgagee or trustee may be the aggrieved party's only remedy.³⁹⁰ This is the critical difference between void and voidable foreclosures, because in the former even bona fide purchasers are subject to the risk of having the sale set aside.

Finally, some defects are so inconsequential as to have *no effect* on the validity of a foreclosure sale. Such defects commonly involve minor discrepancies in the notice of sale. For example, when the first two of four published notices of sale omitted the place of sale, a court held that because there was "substantial compliance" with the requirements specified by the deed of trust and the parties were not affected in a "material way," the sale was valid.³⁹¹ Similarly, a sale was deemed valid when the notice of sale was sent by regular mail rather than by the statutorily required certified or registered mail, and when

It would seem that a mortgagee-purchaser would rarely, if ever, qualify as a bona fide purchaser. Indeed, it is normally the mortgagee or his attorney who manages the power of sale foreclosure proceeding and who would be responsible for defects that arise. Moreover, even where a deed of trust is involved, while the trustee presumably is in charge of the proceedings, it is not unlikely that, for purposes of determining BFP status, he will be treated as an agent of the mortgagee. If the sale purchaser has paid value and is unrelated to the mortgagee, it would seem that he should take free of voidable defects if: (a) he has no actual knowledge of the defects; (b) he is not on reasonable notice from recorded instruments; and (c) the defects are not such that a person attending the sale exercising reasonable care would have been aware of the defect. Where a subsequent grantee is involved, BFP status would seem slightly easier to achieve. If that grantee did not attend the sale, he should be treated as a bona fide purchaser unless he had actual notice of the defect or was on reasonable notice from the recorded documents. Where, however, the sale purchaser or some later purchaser is a BFP, but he conveys to a person such as the original mortgagee who would not otherwise qualify for such status, what should be the result? Most jurisdictions would probably refuse to confer BFP status on the mortgagee (or any intervening purchaser with notice of the defect), since such persons could not reacquire the property in good faith.

NELSON & WHITMAN, *supra* note 17, at 587-88.

390. NELSON & WHITMAN, *supra* note 17, at 586.

391. See *Williams v. S. Cent. Farm Credit, ACA*, 452 S.E.2d 148, 151 (Ga. Ct. App. 1994) (refusing to set aside the sale where the first two publications contained "two substitutions of 'southeast' for 'southwest' in describing an outparcel, and the omission of one line of text referring to a land lot identified immediately below" but the errors "were corrected in the third and fourth publications"); see also *Tarleton v. Griffin Fed. Sav. Bank*, 415 S.E.2d 4, 5-6 (Ga. Ct. App. 1992) (rejecting the claim that a foreclosure was legally defective when it incorrectly referred to the security deed as being at page three rather than page two of county records, because a potential purchaser would not have been misled); *Concepts, Inc. v. First Sec. Realty Servs., Inc.*, 743 P.2d 1158, 1159 (Utah 1987) (refusing to hold a sale invalid because of a typographical error relating to the year of the sale).

the mortgagor had actual notice of the sale for longer than the statutory period before the sale.³⁹²

Against the backdrop and uncertainty of the foregoing classification system, states have attempted to enhance the stability of power of sale foreclosure titles through the enactment of a variety of presumption statutes. Though these statutes vary significantly, they nevertheless seem to fall into three general categories. The first type, which we characterize as “*rebuttable presumption*” legislation, is exemplified by the Missouri statute: “[T]he recitals in the trustee or mortgagee’s deed concerning the default, advertisement, sale or receipt of the purchase money, and all other facts pertinent thereto, shall be received as prima facie evidence in all courts of the truth thereof.”³⁹³ This type of statute, which is found, with minor variations, in over a dozen states,³⁹⁴ contains neither “conclusive presumption” language nor any specific protection for bona fide purchasers. Indeed, a few of these statutes claim to deal only with the *notice* requirements of the foreclosure and not with other aspects that might be carried out improperly.³⁹⁵ At most, the recitals create a rebuttable presumption that there was a valid basis for foreclosure and that the necessary procedural requirements have been satisfied. These statutes seem to do little more than restate the common law notion that the party attacking the validity of a foreclosure sale has the burden of proof. Presumably the rights of a bona fide purchaser under this type of statute would be no greater than those afforded under the common law “void-voidable” classification of power of sale foreclosure defects

392. *Macon-Atlanta State Bank v. Gall*, 666 S.W.2d 934, 937 (Mo. Ct. App. 1984). So too, a notice of default that misstated the number of months of payments in default did not render a sale invalid when the “number of months” information was not required by statute or by the deed of trust. *See Goffney v. Family Sav. & Loan Ass’n*, 98 Cal. Rptr. 2d 497, 512–15 (Ct. App. 2000) (unpublished decision) *modifying* 98 Cal. Rptr. 2d 497 (Ct. App. 2000). For a complete catalogue of defects deemed “insubstantial,” see *Graham v. Oliver*, 659 S.W.2d 601, 604 (Mo. App. Ct. 1983). *See also Burrill v. First Nat’l Bank of Shawnee Mission*, 668 S.W.2d 116, 117 (Mo. App. Ct. 1984) (concluding that a notice of default did not affect the validity of the sale of default although it incorrectly stated the date of the note).

393. MO. REV. STAT. § 443.380 (2000).

394. *See* ALA. CODE § 12-21-99 (1995); *id.* § 35-10-5 (1991); COLO. REV. STAT. § 38-38-504 (2003); ME. REV. STAT. ANN. tit. 14, § 6203-B (West 2003); MASS. ANN. LAWS. ch. 244, § 15 (Law. Co-op. 2003); MICH. COMP. LAWS ANN. § 600.3264 (2000); N.H. REV. STAT. ANN. § 479:26 (2003); N.D. CENT. CODE § 35-22-16 (2004); R.I. GEN. LAWS § 34-13-3 (1995); S.D. CODIFIED LAWS § 21-48-23 (Michie Supp. 2004); TEX. PROP. CODE ANN. § 51.002 (Vernon Supp. 2004); VT. STAT. ANN. tit. 12, § 4531a (2002); VA. CODE ANN. § 8.01-389 (2000); WYO. STAT. ANN. § 34-4-103 (Michie 2003).

395. *See* R.I. GEN. LAWS § 34-13-3; S.D. CODIFIED LAWS § 21-48-23; TEX. PROP. CODE ANN. § 51.002; WYO. STAT. ANN. § 34-4-103.

considered above. Such statutes probably contribute only slightly to the stability of power of sale foreclosure titles.

In the second category of statutes, the inclusion of appropriate recitals creates a conclusive presumption in favor of bona fide purchasers, but this presumption extends only to notice requirements of the sale.³⁹⁶ We label this type of statute “*conclusive presumption for bona fide purchasers—notice only*.” The California statute is typical; it states:

[A] recital in the deed executed pursuant to the power of sale of compliance with all requirements of law regarding the mailing of copies of notices or the publication of a copy of the notice of default or the personal delivery of the copy of the notice of default or the posting of copies of the notice of sale or the publication of a copy thereof shall constitute prima facie evidence of compliance with these requirements and conclusive evidence thereof in favor of bona fide purchasers and encumbrancers for value and without notice.³⁹⁷

As noted earlier, in the absence of such a statute, the failure to mail a statutorily required notice to a mortgagor renders the foreclosure sale void.³⁹⁸ That the property is sold to a bona fide purchaser is irrelevant. No title, legal or equitable, passes at the sale. The statute, however, reduces the impact of the notice defect. In effect, the notice defect is deemed to render the sale only *voidable*. Consequently, a foreclosure sale purchaser or subsequent grantee who qualifies as a bona fide purchaser will hold an indefeasible title despite the failure to give proper notice.³⁹⁹

On the other hand, it is unclear whether the “*conclusive presumption for bona fide purchasers—notice only*” statute will benefit a bona fide purchaser when the defect in the sale process is *procedural* but does not deal with the statutory notice requirements. For example, suppose the person who conducts a foreclosure sale under a deed of trust was improperly replaced as trustee by another

396. See ALASKA STAT. § 34.20.090 (Michie 2002); CAL. CIV. CODE § 2924 (West Supp. 2004); GA. CODE ANN. § 44-14-162.4 (2002); N.C. GEN. STAT. § 45-21.17A (2003); W. VA. CODE ANN. § 38-1-4 (Michie 1997).

397. CAL. CIV. CODE § 2924 (West Supp. 2004).

398. See *supra* note 381 and accompanying text.

399. See *Homestead Sav. v. Darmiento*, 281 Cal. Rptr. 367, 374 (Ct. App. 1991):

A sale is voidable where there is a notice defect and conclusive presumption language and there is no bona fide purchaser for value. Where the evidence establishes that the trustee conveyed title to a bona fide purchaser and the trustee's deed contains the language specified in [the statute], the sale is not voidable.

person a few days prior to the sale. Under the traditional analysis, the sale is void regardless of the sale purchaser's being a bona fide purchaser.⁴⁰⁰ The California statute does not appear to aid the purchaser in that context because a sale by an unqualified trustee does not constitute the type of notice defect that is within the literal purview of the statute. Nevertheless, California cases have left this question unresolved.⁴⁰¹

The third category, which we characterize as “*conclusive presumption for bona fide purchasers—all aspects of foreclosure*” affords the greatest protection for bona fide purchasers. At least fourteen states have this type of legislation.⁴⁰² Washington's statute typifies this category. It requires the foreclosing trustee to issue the foreclosure purchaser a deed that

shall recite the facts showing the sale was conducted in compliance with all of the requirements of this chapter and of the deed of trust, which recital shall be prima facie evidence of such compliance and conclusive evidence thereof in favor of bona fide purchasers and encumbrancers for value.⁴⁰³

UNFA follows this approach. Recording of the proper documents under UNFA “conclusively establishes compliance with this [Act] in favor of purchasers of the collateral in good faith for value.”⁴⁰⁴

400. See *supra* notes 375–84 and accompanying text.

401. Compare *Garfinkle v. Super. Ct.*, 146 Cal. Rptr. 208, 217–18 (1978) (stating that presumptions apply only to the propriety of notice and are inapplicable to the other requirements of the sale process), with *Moeller v. Lien*, 30 Cal. Rptr. 2d 777, 783 (Ct. App. 1994) (“If the trustee's deed recites that all statutory notice requirements and procedures required by law for the conduct of the foreclosure have been satisfied, a rebuttable presumption arises that the sale has been conducted regularly and properly; this presumption is conclusive as to a bona fide purchaser.”). A recent California Court of Appeal decision noted the *Moeller* language but declined to decide whether the statute was applicable to “all significant procedural defects.” *Residential Capital, LLC v. Cal-W. Reconveyance Corp.*, 134 Cal. Rptr. 2d 162, 174 n.4 (Ct. App. 2003).

402. See ARIZ. REV. STAT. ANN. § 33-811 (West Supp. 2003); ARK. CODE ANN § 18–50–111 (Michie 2003); HAW. REV. STAT. ANN. §§ 667-5, -8, -32, -33, -35 (Michie 2003); IDAHO CODE § 45-1510 (Michie 2003); MINN. STAT. ANN. § 580.19 (West 2000); MONT. CODE ANN. § 71-1-318 (2003); NEB. REV. STAT. § 76-1010 (2004); NEV. REV. STAT. ANN. 107.030 (Michie 2001); N.M. STAT. ANN. § 48-10-14 (Michie 1995); N.Y. REAL PROP. ACTS. LAW § 1411 (McKinney Supp. 2004) (repealed effective July 1, 2005); OKLA. STAT. ANN. tit. 46, § 47 (West 1996); OR. REV. STAT. § 86.780 (2003); UTAH CODE ANN. § 57-1-28 (Supp. 2004); WASH. REV. CODE ANN. § 61.24.040(7) (West 2004).

403. WASH. REV. CODE ANN. § 61.24.040.

404. UNFA art. 6, § 605.

The literal language of this type of statute is breathtakingly broad in its impact on bona fide purchasers. Not only does it purport to protect a bona fide purchaser from notice and other procedural defects in the foreclosure process, it is arguably applicable even when the mortgagee had no substantive right to foreclose. Under the UNFA language, the conclusive presumption is that the foreclosure is in compliance with the Act. Because section 201 states that a mortgagee “has a right to foreclose under this [Act] if all conditions required by law and the security instrument as prerequisites to foreclosure are satisfied,”⁴⁰⁵ a court could “bootstrap” the presumption statute to cover every conceivable defect in the mortgage, the obligation, or the right to foreclose. Suppose, for example, that a mortgage is foreclosed even though the obligation that it secures is not in default, or that the mortgage was forged. Under traditional state law, the foreclosure would be void in either instance, and would be set aside even against a sale purchaser who was a bona fide purchaser.⁴⁰⁶ The literal language of UNFA and similar “category three” statutes suggests a different result.

However, the comments to UNFA reject this conclusion:

[Section 605] does not ensure that there are no defects in the security instrument or the creditor’s right to foreclose. For example, if the security instrument is a forgery or was procured by fraud in the execution, the courts typically hold that any foreclosure under it will be void. *This section does not change that result.* Similarly, if the secured obligation was not in default, or had been fully paid, the secured creditor would have had no right to foreclose. *In that case, the conclusive effect of this section will not validate the foreclosure.*⁴⁰⁷

The foregoing language suggests that UNFA was intended to protect bona fide purchasers against defects that arise in connection with the mechanics of power of sale foreclosure but not defects relating to the substantive right to foreclose.⁴⁰⁸ Limiting the conclusive impact of UNFA and statutes like it to procedural defects in the foreclosure process clearly makes sense. To allow a bona fide purchaser to prevail over a mortgagor who was not in default or a person who never executed a mortgage to begin with would be fundamentally unfair, a

405. UNFA art. 2, § 201.

406. See *supra* notes 375–84 and accompanying text.

407. UNFA art.6, § 605 cmt. (emphasis added).

408. See generally NELSON & WHITMAN, *supra* note 17, at 605 (discussing the types of problems that can arise regarding the rights of bona fide purchasers).

normative result that legislatures adopting “category three” statutes probably did not intend.⁴⁰⁹

D. Obtaining Possession after Foreclosure

Once foreclosure has occurred, sale purchasers sometimes have difficulty obtaining physical possession of the real estate from those whose rights the foreclosure has terminated. Of course, in the case of judicial foreclosure, the court entering the foreclosure decree may also enter an order directing the sheriff or other court officer to remove the previous owner and put the purchaser in possession. However, if foreclosure is nonjudicial, the purchaser faces a dilemma when possession is not surrendered voluntarily. Self-help, peaceable or otherwise, generally may not be used to acquire possession.⁴¹⁰ Indeed, use of this nonjudicial remedy may subject the foreclosure purchaser to both criminal and civil liability.⁴¹¹ In many jurisdictions, a summary proceeding (usually termed forcible entry and detainer, unlawful detainer, or summary ejectment) is available to landlords seeking possession from defaulting tenants and may be used by foreclosure purchasers as an efficient dispossession remedy. In a number of states, however, this option may be unavailable to foreclosing parties because it is restricted to use in the landlord-tenant context.⁴¹²

UNFA takes a twofold approach to the possession problem. First, it makes clear that the purchaser “may not dispossess persons in possession . . . without a judicial order or judgment.”⁴¹³ The self-help remedy is barred. Second, it extends the availability of state summary proceedings to foreclosure purchasers. It provides that the purchaser “may gain possession . . . by an action under the [forcible entry and detainer statute of the jurisdiction].”⁴¹⁴

409. *Id.*

410. See Randy G. Gerchick, *No Easy Way Out: Making the Summary Eviction Process a Fairer and More Efficient Alternative to Landlord Self-Help*, 41 UCLA L. REV. 759, 777–78 & n.79 (1994) (“The majority of states, either by express provision in [a forcible entry and detainer] or [unlawful detainer] statute or by judicial interpretation of that legislation, forbid a landlord from using any form of self-help and require the landlord to resort to the judicial remedy in evicting a tenant.”).

411. *Id.* at 780–81.

412. UNFA art. 6, § 606 cmt.

413. *Id.* § 606.

414. *Id.*

To what extent should foreclosed parties be able to attack the validity of an UNFA foreclosure in such summary proceedings? Usually there are a variety of monetary and subject matter jurisdictional limitations on such proceedings.⁴¹⁵ Of course, in the landlord-tenant context, the variety of issues that may be raised in summary proceedings has expanded substantially over the past several decades because of judicial and legislative recognition of the implied warranty of habitability and other tenant protections.⁴¹⁶ Even in this context, however, questions of title or the validity of the lease usually cannot be litigated.⁴¹⁷ In the nonjudicial foreclosure context, the issues or defenses that foreclosed parties can raise in a summary proceeding should be even more circumscribed than in the landlord-tenant setting. The foreclosed debtor should be permitted only to show that no UNFA foreclosure of any kind took place; it should be impermissible to litigate in any manner the *validity* of such a foreclosure. Even substantive claims that normally render a foreclosure void, such as a forged mortgage or no default in the mortgage obligation, should not be considered in a summary proceeding. To do so would inevitably trigger questions of title, given that passage of title is necessarily related to any foreclosure proceeding.

Moreover, the purpose of the summary proceeding in the foreclosure context is only to avoid potential violence by using a sheriff or other law enforcement agent to effectuate a transfer of possession. Summary possession proceedings are often conducted in courts of limited jurisdiction that are poorly equipped to hear arguments based on the subtleties of compliance with the UNFA foreclosure process. Any attacks on the validity of the foreclosure, either substantive or procedural, can and should be raised in a suit to enjoin the foreclosure or in a separate suit for damages or to set aside the sale. To permit challenges to validity in a summary proceeding would encourage persons facing foreclosure to refuse to relinquish possession voluntarily and to raise all of their claims and defenses in

415. STOEBUCK & WHITMAN, *supra* note 302, at 394.

416. *Id.* at 395.

417. See *Puget Sound Inv. Group, Inc. v. Bridges*, 963 P.2d 944, 946 (Wash. Ct. App. 1998) (holding that unlawful detainer actions do not afford the opportunity to litigate title issues); Andrew J. Wiegel, *Unlawful Detainer: Preparing and Filing the Action*, in CALIFORNIA LANDLORD-TENANT PRACTICE § 9.6 (Cal. Continuing Educ. of the Bar, 2d ed. 2002) (“[T]he issues that can be raised are strictly limited to possession and closely related to ancillary matters such as recovery of back rent, damages, and attorney fees.”).

the summary possession proceeding. Every UNFA foreclosure might then become a judicial proceeding, and its purpose of providing a fair and efficient nonjudicial foreclosure mechanism would be thwarted. This is hardly what UNFA's drafters intended or what any enacting legislature would desire.

VI. SHOULD UNFA BE ENACTED BY CONGRESS?

This Article demonstrates, we believe, that UNFA represents an innovative, flexible, and efficient foreclosure procedure. As such, it should be especially appealing to lenders. At the same time, however, it carefully assures fairness to borrowers. Residential debtors are afforded a variety of safeguards including substantial grace periods and, if they act responsibly, immunity from deficiency judgments. In short, UNFA reflects a careful balancing of the legitimate interests of both lenders and debtors and represents a major advance in conceptualizing the foreclosure process.

What then is the likelihood of UNFA's adoption by the states? If the past provides any indication, its chances are slim indeed. Although we fervently hope otherwise, it seems highly likely that if the quest for uniformity is left to the states, UNFA will suffer the same fate as its ULSIA predecessor.

We suggest that UNFA's future may lie with Congress. In view of the enormous impact of mortgage financing on the national economy and the dramatic growth of the secondary market for mortgages, the current hodgepodge of state foreclosure law and its attendant inefficiencies make a compelling case for national uniformity. This view, of course, is not universal. Professor Michael Schill, for example, has taken the position that the case for uniformity has yet to be convincingly made.⁴¹⁸ In his view, "non-uniform mortgagor protection laws in the context of residential real estate [are] likely to generate only modest costs."⁴¹⁹ He concluded in 1999

418. See Michael H. Schill, *The Impact of the Capital Markets on Real Estate Law and Practice*, 32 J. MARSHALL L. REV. 269, 286–87 (1999) (critiquing uniform laws governing real estate foreclosures and the wisdom of federal preemption).

419. *Id.* at 286. Professor Schill summarizes that, in two earlier articles, he found "that the effect of anti-deficiency laws was statistically insignificant and that an eleven month statutory right of redemption was associated with an increase in interest of only seven basis points." *Id.*; see Schill, *supra* note 47, at 1292 (finding "the costs attributable to [such] laws quite modest"); Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 498, 512 (1991) ("With respect to the legal variables, a law prohibiting deficiency judgments is estimated to increase home mortgage loan interest rates by 6.7 basis points.").

that “even if the laws were costly and inefficient, there [would be] no reason for the federal government to supplant the judgment of the citizens of states [that had enacted these laws], at least in the absence of significant externalities.”⁴²⁰ However, an impressive 2003 study by Karen Pence for the Federal Reserve System points to significant externalities.⁴²¹ Even though she concludes that statutory redemption laws “do not appear to affect the mortgage market substantively,”⁴²² and her findings about the impact of deficiency prohibitions are inconclusive, she establishes “a robust inverse relationship between a judicial foreclosure requirement and mortgage loan size.”⁴²³ Overall, she finds that “defaulter-friendly” foreclosure laws are correlated with a 4 to 6 percent decrease in loan size.⁴²⁴ This result suggests that “defaulter-friendly” foreclosure laws “may assist homeowners experiencing hard times, but they also impose costs on a much larger pool of borrowers at the time of loan origination.”⁴²⁵ We are convinced that national uniformity would be highly desirable.

Congressional adoption of UNFA could take a variety of forms. The most far-reaching approach would be for Congress to make it applicable to every mortgage transaction in the United States. Every lender in the country would then have the option to utilize UNFA as a nonjudicial foreclosure remedy. Note that this approach would mainly affect state foreclosure *procedure* and would not alter *substantive* mortgage law. For example, such a congressional enactment of UNFA would have no impact on local law governing priorities, subrogation, mortgage modification, future advances, payment and discharge, or countless other substantive law issues. A less sweeping approach would be for Congress to make UNFA applicable to the foreclosure of mortgages sold on the secondary market. An even less dramatic option would entail applying UNFA only to the foreclosure of mortgages held by federal agencies and the government-sponsored secondary market entities (Fannie Mae,

420. Schill, *supra* note 418, at 286–87.

421. PENCE, *supra* note 20, at 5.

422. *Id.* at 27.

423. *Id.*

424. *Id.* at 1.

425. *Id.* at 27–28. Other studies have found higher interest rates in defaulter-friendly states. See CLAUDIA E. WOOD, *THE IMPACT OF MORTGAGE FORECLOSURE LAWS ON SECONDARY MARKET LOAN LOSSES* (1997); Mark Meador, *The Effect of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143, 143–48 (1982) (studying the effects of state foreclosure laws on regional mortgage rates).

Freddie Mac, and Ginnie Mae). That approach would assure secondary market investors that the time and cost of mortgage foreclosure would not vary by the location of the mortgaged real estate.

Another course of action would invoke a variation on the “states as laboratories” concept.⁴²⁶ Under this view, uniformity imposed by Congress is dangerous because unwise legislation would harm the entire nation until it is repealed or amended. By contrast, when legislation is adopted one state at a time, the harm is localized and can be corrected before the country as a whole is injured.⁴²⁷ Applying this philosophy to UNFA would require waiting several years to see if it is adopted by at least a handful of states. If this were to occur, then there could be careful analysis of its impact. A favorable assessment would support adoption by Congress. A less positive evaluation would point to its rejection or substantial amendment by Congress. If, as seems more likely, state enactment of UNFA does not occur, further delay by Congress would not be justified and prompt federal action would be appropriate.

Congressional adoption of UNFA in any of the above variants would be appropriate under the Commerce Clause. Under current Supreme Court jurisprudence, Congress can reach “those activities that substantially affect interstate commerce.”⁴²⁸ To be sure, unlike the UCC, which focuses on the sale and mortgaging of moveable property, UNFA deals with real estate, which, by its very nature, remains in one place. Nevertheless, under the Court’s current approach, although any individual mortgage foreclosure may not substantially affect commerce in more than one state, “a rational

426. See *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932), in which a dissenting Justice Brandeis noted:

Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.

427. *Id.*

428. *United States v. Lopez*, 514 U.S. 549, 559 (1995); see also, e.g., Nelson, *supra* note 35, at 1249 (“Congress could reasonably conclude that the total impact of such mortgages and their foreclosures substantially affect commerce in more than one state.”); Grant S. Nelson & Robert J. Pushaw, Jr., *Rethinking the Commerce Clause: Applying First Principles to Uphold Federal Commercial Regulations but Preserve State Control over Social Issues*, 85 IOWA L. REV. 1, 168 (1999) (“In view of the enormous impact of mortgage financing on the national economy . . . [s]uch a [mortgage] statute would survive a commerce clause challenge . . .”).

Congress could conclude that the cumulative impact of such transactions on the national mortgage market does so.”⁴²⁹

Some may argue that congressional adoption of a uniform act threatens the underlying values of the National Conference of Commissioners on Uniform State Laws (Conference). The Conference’s main *raison d’être* since the late nineteenth century has been to “promote uniformity in the law among the several States on subjects as to which uniformity is desirable and practicable.”⁴³⁰ Nevertheless, because of our substantial involvement with the Conference,⁴³¹ we can attest to the fact that, however desirable the goal of uniformity, it is secondary to a more compelling concern—the threat of federal preemption. Conference members commonly argue that “unless we act, Congress will do it for us.” This view seems to reflect an underlying federalist ideology, dictating that uniformity should only be achieved by the individual assent of each of the several states.

Our intuitive reaction, on the other hand, is much more pragmatic. At least as to commercial issues, if uniformity is so important, why not let Congress do it? After all, with the exception of such major projects as the UCC, acts are rarely adopted by all of the states. Even well-received products such as the Uniform Fraudulent Transfer Act, the Uniform Transfers to Minors Act, and the Uniform Probate Code have failed to achieve unanimous adoption.⁴³² Thus, the promulgation of most so-called “uniform” acts fails to achieve the desired uniformity.

Perhaps it is time for the Conference to adopt a new perspective. There is a strong case that uniform acts dealing with commercial transactions *ought* to be enacted by Congress under its Commerce Clause power. Under this paradigm, future versions of the UCC would be enacted by Congress. So too would UNFA. The Conference would continue to produce only acts dealing primarily with local

429. Nelson & Pushaw, *supra* note 428, at 168. See also the discussion of the federally sponsored secondary mortgage market at *supra* notes 36–37 and accompanying text.

430. NAT’L CONFERENCE OF COMM’RS ON UNIF. LAWS, CONSTITUTION AND BYLAWS § 1.2, available at <http://www.nccusl.org/nccusl/DesktopDefault.aspx?tabindex=3&tabid=18>.

431. Grant Nelson was a Commissioner from Missouri from 1982 to 1991 and Dale Whitman served as Reporter for UNFA from 1999 to 2002.

432. The Uniform Fraudulent Transfer Act, 7A U.L.A. 1 (2002), has been adopted by thirty-nine states, the Uniform Transfers to Minors Act, 8C U.L.A. 1 (2002), by forty-eight states and the Uniform Probate Code, 8 U.L.A. 1 (2002), by sixteen states. Even the UCC, although adopted by all of the states, is not totally uniform. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 7 (3d ed. 1988).

social and cultural concerns, such as the Uniform Marriage and Divorce Act and the Uniform Probate Code.

This “bifurcated function” approach for the Conference is hardly a radical suggestion. Uniform acts involve a time-consuming, deliberate, multidraft process that generally takes at least three or four years, and the result is almost always a high-quality product—at least equal in quality to typical acts of Congress. State influence on uniform acts is substantial. They are drafted and considered by a body of commissioners that draws its financial support largely from state governments.⁴³³ Perhaps more importantly, the membership of the Conference is comprised of leading lawyers, judges, and academics who are appointed by a political process in each of the states.⁴³⁴ Indeed, uniform acts probably receive much more local and state input than the usual legislation enacted by Congress. Consequently, if uniformity in commercial matters is desirable, why not let it come in the form of a congressionally enacted uniform act produced by the Conference’s careful deliberative process that substantially reflects state concerns? If the Conference and Congress adopted this cooperative approach, the Conference could achieve an impact in the new millennium that would far exceed its influence on the development of the law in the twentieth century.

CONCLUSION

UNFA represents the first effort in the modern era to formulate a foreclosure statute that creatively addresses the manifold problems of nonjudicial foreclosure.⁴³⁵ Some of its concepts are admittedly untested, but they represent the best thinking of a highly qualified and experienced group of lawyers who worked on the project for four

433. <http://www.nccusl.org/nccusl/aboutus.asp#financial> (last visited June 5, 2002) (on file with the *Duke Law Journal*) (“The major portion of financial support for the Conference comes from state appropriations. Expenses are apportioned among the states by means of an assessment based on population.”).

434. Although the method of appointment of commissioners to the Conference varies among the states, three patterns are discernable. In some states, they are appointed by the governor and confirmed by the senate. In other states, the sole appointing authority is the legislature. In a third approach, some states give both the governor and the legislature the exclusive authority to appoint a fixed number of commissioners. Telephone Conversation between John M. McCabe, Legislative Director and Legal Counsel of NCCUSL, and Grant S. Nelson (June 4, 2002).

435. The Oklahoma statute, adopted in 1986, is perhaps the closest analogous effort. See OKLA. STAT. ANN. tit. 46, §§ 40–49 (West 1996). It was carefully crafted but did not attempt to provide alternatives to the traditional auction sale.

years.⁴³⁶ UNFA is remarkably thorough, dealing with many issues that most other foreclosure statutes gloss over. It is straightforward and relatively easy to follow. It represents a reasonable balance of lenders' and borrowers' interests, and it grants substantial protections to residential borrowers. Most importantly, it vastly increases the probability that foreclosures will bring prices that approach market value. We think that it deserves to see the light of legislative day, either by state or congressional enactment.

436. The initial meeting of the drafting committee was held on September 17–19, 1999. The final draft was approved by the Commissioners in August 2002.